

# Put and Call Option Agreement (Japan): Checklist

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Checklists | [Law stated as of 01-May-2022](#) | Japan

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A checklist of the key considerations when drafting a put and call option agreement to make it compliant with Japanese law. Key considerations include the option exercise period, exercise price, restrictions on transfer, anti-dilution mechanisms, and other typical features of a put option and call option agreement in respect of shares in non-listed public and private companies in Japan.

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This Checklist sets out the key issues to consider when tailoring a put option and call option agreement in respect of shares in non-listed public and private companies to make it compliant with Japanese law.

It provides background commentary in relation to issues of Japanese law that may impact [Standard Document, Put and Call Option Agreement: Cross-Border](#). Where clauses in this Standard Document need to be amended to comply with Japanese law, suggested drafting is provided.

Unless otherwise stated, a reference in this Note to:

- Civil Code means the Civil Code (Act No. 89 of 1896, as amended).
- Companies Act means the Companies Act (Act No. 86 of 2005, as amended).

## What Are Put or Call Options?

A right to purchase, or a [call option](#), is generally understood to be a right (but not an obligation) for its owner to purchase assets for a fixed or indefinite period, usually at a predetermined price.

Conversely, a right of sale, or a [put option](#), is considered a right (but not an obligation) for the owner to sell assets for a fixed or indefinite period, usually at a predetermined price.

Usually, the purchase or sale agreement is triggered by a single statement from the owner to exercise the option. The statement does not have to be in writing, but in practice it should be. Apart from issuing this statement, there is nothing further the owner of an option must do to exercise their option rights.

Depending on the contractual provisions, following the exercise of the option right, a separate purchase or sale agreement may need to be concluded between the parties to effect the purchase or sale. A put or call option agreement is a type of option contract. One type requires the other party to accept the offer. Another type may immediately form a main contract upon a manifestation of intention to complete an option contract. The right to complete an option contract is deemed to be a right to form (*Articles 556 (1) and 559, Civil Code*). Under the laws of Japan, the right to form means the right to cause certain fluctuations in the legal relationship by unilateral manifestation of intention of the right holder.

If shares in non-listed public and private companies are subject to put or call options issued by the company, special provisions in the Companies Act come into play. The issuance of share options, meaning any right entitling the holder to acquire shares in a company by exercising the right against that company (*Article 2 (xxi), Companies Act*), requires a resolution at a shareholders meeting (*Article 238 (2), Companies Act*) or at a board of directors meeting (*Article 240 (1), Companies Act*) and registration in the commercial register administered by the Legal Affairs Bureau (*Article 911 (3) (xii), Companies Act*). Provisions in the Articles of Incorporation are required for the issuance of:

- Shares with a put option, meaning shares with a feature providing a shareholder with the right to demand the company to redeem all or part of such shares (*Article 2 (xviii), Companies Act*).
- Shares subject to call, meaning shares with a feature providing a company with the right to redeem all or part of such shares upon the occurrence of specified event (*Article 2 (xix), Companies Act*).
- Shares subject to class-wide call, meaning a class of shares with a feature providing a company with the right to acquire all such class shares by a resolution at a shareholders meeting (*Article 171 (1), Companies Act*).

(*Articles 107 (2) and 108 (2), Companies Act*).

In the case of a shareholders' agreement (which would be concluded between all shareholders in practice to determine the operation of a company when establishing it as a joint venture company to conduct joint business on the basis of a relationship of trust between a small number of parties) or an agreement between a shareholder and a third party, the share transfer option agreement may be concluded without writing (*Article 522 (2), Civil Code*), but in practice it should be. There are special provisions in the Companies Act regarding the method of transferring shares (*Articles 128 and 130, Companies Act*). In the case of shares with a restriction on transfer (*Article 2 (xvii), Companies Act*), approval of the company by a resolution at a shareholders meeting or at a board of directors meeting is required (*Article 139 (1), Companies Act*).

The option is freely transferable unless limitations on transferability apply (see [Transfers to Third Parties](#)).

## Option Exercise Period

There are no mandatory legal provisions in Japan that prescribe the time frame within which the option should be exercised. The exercise period may be specified in the right to complete an option contract. The right to complete an option contract is extinguished by a notice of demand specifying a reasonable period (*Article 556 (2), Civil Code*) from the other party if the exercise period is not specified. The extinctive prescription of claims (*Article 166 (1), Civil Code*) applies (*Supreme Court, November 6, 1958, 12 Minshu 3284*). The exercise period can be set longer than the prescription period (*Grand Court, April 22, 1938, 17 Daihan Minshu 770*).

When Japanese companies issue share options and shares with a put option, the exercise period (*Article 236 (1) (iv), Companies Act*) and the acquisition period (*Articles 107 (2) (ii) (f) and 108 (2) (v) (a), Companies Act*) must be specified.

The definition of "Option Period" in [Standard Document, Put and Call Option Agreement: Cross-Border](#) is valid under Japanese law and would not need to be amended.

## Acceleration Events

It is uncommon for an option agreement in Japan to set out exercise acceleration events, such as when the company is subject to a third-party offer. However, it is possible to include acceleration mechanisms in the option agreement.

In shareholders' agreements, it is usually possible to exercise call or put options when certain events such as default and deadlock occur. The effect of a third-party offer is usually addressed with the consent restriction clause and the first refusal right clause in shareholders' agreements.

The definition of "Third Party Offer" in [Standard Document, Put and Call Option Agreement: Cross-Border](#) should be amended as follows:

"an offer by a third party for [the entire issued shares of the Company OR all of the issued [CLASS] of [shares OR securities] to which the Option Shares belong."

## Consideration for the Grant of a Call or Put Option

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

It is uncommon 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). A share option is permitted under the Companies Act as consideration for the acquisition of shares with a put option, shares subject to call and shares subject to class-wide call (*Articles 107 (2) (ii) (c) and (iii) (e) and 171 (1) (i) (c), Companies Act*).

A company can grant a share option for the issuance of shares to a third party if the grant is approved by a special resolution at a shareholders meeting (*Article 238 (2), Companies Act*).

Where there is no requirement for monies to be paid in exchange for the share options and this is "particularly favourable" to the proposed subscribers, or where the exercise price for the share options is particularly favourable to the proposed subscribers, the directors of the company must explain the reasons for the need to solicit subscribers in this manner (that is, through the grant of a share option) at the shareholders meeting and before voting on the relevant resolution (*Article 238 (3), Company Act*).

Except for the cases set out in Article 236 (3) of the Companies Act, a non-listed public company can grant a share option for the issuance of shares to a third party if approved by a resolution at a board of directors meeting (*Article 240 (1), Companies Act*).

A company can grant share options to shareholders entitling them to an allotment of shares (*Article 241 (1), Companies Act*) by a resolution at a board meeting of a non-listed public company or a special resolution at a shareholders meeting of a private company (*Article 241 (3), Companies Act*). A share option may be allotted to shareholders without contribution by a resolution at a board of directors meeting (*Article 277, Companies Act*).

The issuance of share options without a special resolution at a shareholders meeting with a particularly favourable exercise price is cause for an injunction (*Article 247, Companies Act*), but not cause for invalidation (*Article 828 (1) (iv), Companies Act*).

[Standard Document, Put and Call Option Agreement: Cross-Border](#): [clause 3.1](#) and [clause 3.2](#) are valid under Japanese law and would not need to be amended.

## Determination of Exercise Price

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

In a shareholders' agreement, if the value of acquiring shares by exercising the call or put option is not appropriate, it may be judged invalid as contrary to public policy under Article 90 of the Civil Code. When agreeing on an exercise price with a fixed amount, it is often agreed on the acquisition price, and in the case of evaluation at the time of exercise, it is often agreed on the book value net asset method. It may be agreed that if a party makes an application to sell its shares at a certain price to the other, the other may agree to buy the shares at that price or sell its shares to the other party at the same price.

The acquisition price of shares subject to class-wide call may be free of charge, but a special resolution at a shareholders meeting is required (*Article 171 (1), Companies Act*), and shareholders who are dissatisfied with the acquisition price can file a petition with the court for the determination of the acquisition price (*Article 172 (1), Companies Act*).

[Standard Document, Put and Call Option Agreement: Cross-Border: clause 7.2](#) is valid under Japanese law and would not need to be amended.

## Exercise Price Set at Fair Market Value

Often the parties agree to fix the exercise price at the fair market value of the shares on the date the option is exercised. The fair market value is the price at which a willing seller would sell and a willing buyer would buy in an arm's length transaction, without time constraints, motivated by normal business considerations.

Fair market value is determined by reference to the financial results of the company based on its financial condition at a given date. In judicial precedents, market value or book value net asset method, profit return method, discounted cash flow (DCF) method, dividend return method, similar industry ratio method, or a combination of these methods, have been adopted. When a certified public accountant is asked for an appraisal, an appraisal that complies with the Corporate Value Evaluation Guidelines of the Japanese Institute of Certified Public Accountants is carried out.

## Independent Determination

In a shareholders' agreement containing a put or call option, it is possible for the option clause to provide for the appointment of an expert(s) to calculate the exercise price of the option if the parties cannot agree on the exercise price calculation under the pricing mechanism stipulated therein. When appointing an expert(s), it is necessary to agree whether the parties can dispute the calculation price of the expert(s) and who bears the costs of the expert(s). When appointing multiple experts, it is necessary to agree how to adjust the difference between their calculation prices.

In the case where the parties agree to fix the exercise price at the fair market value of the shares on the date the option exercise, the remit of the independent expert will generally be not limited to applying the pricing mechanism under the contractual terms.

[Standard Document, Put and Call Option Agreement: Cross-Border: clause 7.3](#) is valid under Japanese law and would not need to be amended.

## Consideration in the Form of Shares in the Buyer

The issuance of shares by the buyer as consideration for either a put or call option over shares in non-listed public and private companies is not a common structure in Japan. When contributing property other than monies in the exercise of share options, it is necessary to be investigated by an inspector appointed by the court unless it falls under an exception (*Article 284, Companies Act*).

A new share or a treasury share is permitted under the Companies Act as consideration for the acquisition of shares with a put option, shares subject to call and shares subject to class-wide call (*Articles 108 (2) (v) (b) and (vi) (b) and 171 (1) (i) (a), Companies Act*). When a company acquires its own shares from shareholders, the company can issue share options over a different type of its own shares in exchange.

[Standard Document, Put and Call Option Agreement: Cross-Border](#): [clause 7.1](#) is valid under Japanese law and would not need to be amended.

## Statutory Restrictions on Transfer of Shares

There are no statutory provisions automatically granting pre-emption rights to existing shareholders of a non-listed public or private company before the issuance of a share option to a third party.

### Transfers to Third Parties

Because an option is deemed to be a right to form that the owner can make effective at will, it is important to consider the transferability of the option (see [What Are Put or Call Options?](#)). The consent of the other party is not required to transfer the right to complete an option contract (*Grand Court, February 29, 1924, 3 Daihan Minshu 80*). In the case of transfer of contractual status, the consent of the other party is required (*Article 539-2, Civil Code*). The requirements for perfection of assignment of claim (*Article 467, Civil Code*) apply to the transfer of the right to complete an option contract (*Grand Court, February 29, 1924, 3 Daihan Minshu 80*). The method of transfer of share options is stipulated by the Companies Act (*Article 255 (1), Companies Act*), and the change of name of holder in the share option register is the requirement for perfection of transfer of share options (*Article 257 (1), Companies Act*).

In the option agreement, the parties can either limit the transferability of the option or provide that it can be freely transferred. Transfer of share options can be restricted as a feature of share options (*Article 236 (1) (vi), Companies Act*). Even if the company does not approve the transfer, the obligation of purchase does not occur to the company.

## Employee Consultation

If the exercise of an option results in a transfer of control through a share purchase, there generally is no statutory requirement to consult with or notify employees of the company because the share purchase does not cause a change in working conditions or otherwise impact existing employment contracts.

For more information on employment law issues to consider when acquiring a private company or a business in Japan, see [Practice Note, Employees: Cross-Border Private Acquisitions \(Japan\)](#).

## Dividends

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 the buyer is registered, a Japanese company must only treat the shareholder listed on the shareholder register as the shareholder entitled to receive distributions (*Article 130, Company Act*). The dividend resolution results in the right to claim specific dividends by shareholders on the shareholder register as of the record date (*Article 124 (1), Companies Act*). Usually, the Articles of Incorporation stipulate that the fiscal year-end is the record date for exercising voting rights at the annual shareholders meeting and receiving dividends.

It may be provided in the option agreement that the dividend received by the seller shall be paid to the buyer or that the seller shall assign to the buyer the right to claim a specific dividend and shall satisfy the requirement for perfection of assignment of claim (*Article 467, Civil Code*). Share options cause the holder to become a shareholder on the date it is exercised (*Article 282 (1), Companies Act*), and the change of name of holder in the shareholder register is not a requirement for perfection. Shares with a put option cause the company to acquire such shares on the date the request is made (*Article 155 (iv), etc., Companies Act*), and the change of name of holder in the shareholder register is not a requirement for perfection. The handling of dividends must be stipulated in the Articles of Incorporation.

Standard Document, Put and Call Option Agreement: Cross-Border: [clause 3.3](#) is valid under Japanese law and would not need to be amended.

## Warranties in an Option

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

- Seller's legal capacity.
- Seller's authority to grant the option.
- Completion of all necessary internal procedures for the grant of the option.
- Accuracy and legality of the seller's signature.
- 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.

Standard Document, Put and Call Option Agreement: Cross-Border: [clause 10](#) is valid under Japanese law and would not need to be amended.

## Anti-Dilution Mechanisms

In a shareholders' agreement, to prevent dilution, it is usually stipulated that, when issuing new shares, the parties shall have the right to subscribe for them according to the shareholding ratio of the shareholders. Other than that, it is uncommon in Japan 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.

When issuing shares with a put option that convert preferred shares into common shares, to prevent new shares from being issued at an issue price lower than the conversion price, so that they can be diluted, it is usual to set out a non-dilution clause in the Articles of Incorporation to adjust the conversion ratio by using a narrow-based or broad-based weighted average method or a full ratchet method. When issuing share options, similar provisions are usually specified by a resolution at a shareholders meeting or a resolution at a board of directors meeting to adjust the exercise price.

Standard Document, Put and Call Option Agreement: Cross-Border: [clause 9](#) is valid under Japanese law and would not need to be amended.

## Formalities to Transfer the Shares on Exercise

## Share Certificate (In the Case of the Share Certificate-issuing Company)

When the share option or the share transfer option is exercised, the public company issuing the share option or the seller under the share transfer option must deliver the share certificate to the holder or the buyer. Share options cause the holder to become a shareholder on the date it is exercised (*Article 282 (1), Companies Act*). Shares with a put option cause the company to acquire such shares on the date the request is made (*Article 155 (iv), etc., Companies Act*).

A private company may elect not to deliver share certificates until shareholders so request (*Article 215 (4), Companies Act*). The transfer of shares takes effect with the delivery of share certificates (*Article 128 (1), Companies Act*).

## Shareholder Registry (Both in the Case of the Share Certificate-issuing Company and Shares Certificate-non-issuing Company)

The shareholder registry must be updated for the issuance of shares under the share options and the transfer of shares under a share transfer option. In the case of exercise of share options, the change of name of holder in the shareholder register is not a requirement for perfection. Since share options are registered in the commercial register administered by the Legal Affairs Bureau, if the holder exercises them and becomes a shareholder, the company needs to apply for the registration of changes (*Article 915, Companies Act*).

In the case of acquisition of shares with a put option, the company needs to apply for the registration of changes when a new share or a [treasury share](#) or a share option is granted as consideration (*Article 915, Companies Act*).

In the case of a transfer of shares under a share transfer option, the change of name of shareholder in the shareholder register is the requirement for perfection of transfer of shares (*Article 130 (1), Companies Act*). In the case of shares with restriction on transfer (*Article 2 (xvii), Companies Act*), approval of the company by a resolution at a shareholders meeting or a resolution at a board of directors meeting is required (*Article 139 (1), Companies Act*).

Standard Document, Put and Call Option Agreement: Cross-Border: [clause 8.4](#) should be amended as follows:

"[At the time of Completion, the delivery of share certificates (if any) from the Seller to the Buyer shall take place and following Completion, each of the parties shall at the expense of the Seller ensure the entry of the Buyer (or as it directs) as the holder of the Option Shares in the shareholder register.]"

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