

## New Method of Cash-out: Demand for Sale of Shares

A new method of cash-out, the **Demand for Sale of Shares**, will be introduced in order to improve the procedure for the exit of minority shareholders from a company. This procedure forces minority shareholders to sell their shares to majority shareholders following the approval of such sale by the target company. The amendment bill of the Companies Act which will enable this procedure is expected to be submitted to the ordinary session of the Diet in 2013.

### Introduction

A "**cash-out**" (or "**squeeze-out**") is a procedure which forces minority shareholders to exit from a company for cash consideration. It is used to acquire the entire share capital of a target company (a listed company) after it is delisted following a management buyout ("**MBO**") or cancellation of a parent/subsidiary listing and the need for such a procedure is high in practice. Although a share exchange (*kabushiki-kokan*) or a merger for cash consideration is permitted under the Companies Act (the "**Act**"), these options are rarely chosen because they give rise to taxation as a non-qualified corporate reorganisation based on the market value of the target company.

In practice, in order to avoid such taxation, a cash-out is conducted by the following procedure: (a) creating a class of shares subject to a class-wide call (the "**Class Shares**") by amending the Articles of Incorporation, which requires a special resolution of the meeting of the shareholders<sup>1</sup>; and (b) acquiring such Class Shares, which requires a special resolution of the meeting of the shareholders<sup>2</sup> and delivering the sales proceeds from the fractional shares to the minority shareholders.

However, as Class Shares were originally introduced to facilitate a 100% capital reduction for companies with excessive debt, there is an element of the procedure having developed without clarification regarding the requirements for a valid cash-out. In addition, from the minority shareholders' perspective, if a tender offer precedes the cash-out, the timing for their exit from the target company will be later on in the process, which may increase the pressure on such minority shareholders to accept the cash-out.

### New Method of Cash-out: Demand for Sale of Shares

The introduction of a method that forces minority shareholders to sell their shares or shares and share options to majority shareholders following the approval of the target company has been described as a new method of cash-out (the "**Demand for Sale of Shares**<sup>3</sup>") in Chapter 2, Section 2 titled "Cash-out" of the "Outline regarding Review of the Corporate Legislation<sup>4</sup>" approved by the Assembly Meeting of the Legislative Council of the Ministry of Justice and submitted to the Minister of Justice on 7 September 2012.

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<sup>1</sup> Article 108, Paragraph 2, Item 7 of the Act; Article 466 of the Act; and Article 309, Paragraph 2, Item 11 of the Act

<sup>2</sup> Article 171, Paragraph 1 of the Act and Article 309, Paragraph 2, Item 3 of the Act

<sup>3</sup> The "Demand for Sale of Shares" means the demand for the sale of shares or shares and share options.

<sup>4</sup> See website of the Ministry of Justice (<http://www.moj.go.jp/content/000100819.pdf>) (in Japanese only). See also the "Supplement to the Interim Plan for Review of the Corporate Legislation" prepared by the Office of the Counsellor, Civil Affairs Bureau of the Ministry of Justice in December 2012 (<http://www.moj.go.jp/content/000082648.pdf>).

## Details of the Demand for Sale of Shares Process

If nine-tenths (9/10ths) or more of the voting rights of a stock company (*kabushiki kaisha*) (the "**Target Company**") (or a higher percentage if set out as such under the Articles of Incorporation of such Target Company) are held by one person or company (the "**Special Majority Shareholder**") they are entitled to demand, with approval of the Target Company, that all of the shareholders of such Target Company (except for the Target Company and the Special Majority Shareholder) (the "**Selling Shareholders**") sell all of their shares in the Target Company (the "**Sale Shares**") to the Special Majority Shareholder.

The Demand for Sale of Shares has advantages compared to a cash-out as described in paragraphs (i) to (iii) below and has the same advantage as a cash-out as described in paragraph (iv) below:

- (i) no resolution of the meeting of the shareholders or consent of the Selling Shareholders is required;
- (ii) it is possible to cash-out the holders of share options and bonds with share options;
- (iii) a wholly-owned subsidiary held by a Special Majority Shareholder can remain as a shareholder of the Target Company at the option of the Special Majority Shareholder; and
- (iv) tax is imposed on capital gains only and not on the market value of the Target Company.

## Demand for Sale of Shares Procedure

### Fulfilment of the Requirements for the Special Majority Shareholder(s)

The person who makes the Demand for Sale of Shares is required to be a Special Majority Shareholder. Such person can be a company, a legal person or a natural person.

There are no restrictions on how the Special Majority Shareholder acquired their stake in the Target Company and it can be by way of tender offer, allocation of new shares to a third party by the Target Company or acquisition of treasury shares. Non-public companies can be the Target Company.

### Demand for Sale of Shares by the Special Majority Shareholder(s)

If a Special Majority Shareholder is intending to make a call for the Sale Shares, they are required to notify and obtain approval of the Target Company of its intention to make such a demand before the acquisition of the Sale Shares can take place.

The Special Majority Shareholder does not need to notify each Selling Shareholder individually when making such call.

The same procedure applies to a call for the sale of share options.

### Approval of the Target Company

The directors or the board of directors of the Target Company who have received the notice of the Demand for Sale of Shares have to determine whether to approve such a demand.

The determination of such approval is required to be made before the day that is twenty (20) days prior to the date of acquisition (the "**Acquisition Date**") as designated by the Special Majority Shareholder. If the determination by the Target Company is not made by such date, the approval will be deemed not to have been given.

### Notice or Public Notice to Selling Shareholders

If the Target Company approves the Demand for Sale of Shares, it will send a notice to the Selling Shareholders or publish a public notice.

The Demand for Sale of Shares is deemed to be made by such notice or public notice.

### Withdrawal of the Demand for Sale of Shares

The Special Majority Shareholder may withdraw the Demand for Sale of Shares if such withdrawal is approved by the Target Company by the day immediately preceding the Acquisition Date.

### **Date of Acquisition**

The Special Majority Shareholder will acquire all of the Sale Shares on the Acquisition Date.

The due date for payment of the consideration for the Sale Shares can be the Acquisition Date. However, as the acquisition is not required to be conducted concurrently with the payment, the Special Majority Shareholder may exercise its rights as a shareholder of the Sale Shares, on or after the Acquisition Date even if it has not paid the consideration for such Sale Shares.

## **Protection of Selling Shareholders**

### **Demand for an Injunction**

Selling Shareholders are entitled to demand an injunction against the Demand for Sale of Shares in the following cases: (A) the Demand for Sale of Shares is in breach of the law; (B) the Target Company has not complied with the obligation of giving notice, publishing the public notice or advance record-keeping; or (C) the Selling Shareholder(s) is likely to suffer a disadvantage where the determined price of the Sale Shares is unreasonably unfair.

### **Petition for Determination of the Price**

Selling Shareholders may file a petition with a court for a determination of the sale price of the Sale Shares during the period which is twenty (20) days prior to the Acquisition Date and the day immediately preceding the Acquisition Date.

### **Action for Invalidity of the Acquisition of Selling Shares, etc.**

The claim regarding the invalidity of the acquisition of the Sale Shares made by the Demand for Sale of Shares can only be made by an action being brought within six (6) months after the Acquisition Date (or one (1) year if such shares are those of a non-public company).

Where a judgement to approve such demand is confirmed, the validity of such acquisition will be denied prospectively and such judgment will also be effective against third parties.

## **Upcoming updates**

The amendment bill of the Companies Act which is in accordance with the "Outline regarding Review of the Corporate Legislation" is expected to be submitted to the ordinary session of the Diet in 2013.

*Where Japanese legal concepts have been expressed in the English language, the concepts concerned may not be identical to the concepts described by the equivalent English terminology as they may be interpreted under the laws of other jurisdictions.*

## Contacts

If you would like to know more about the subjects covered in this publication or our services, please contact:



**Tatsuhiko Kamiyama**  
Partner

T: +(81 3) 5561 6395  
E: tatsuhiko.kamiyama  
@cliffordchance.com

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Clifford Chance, Akasaka Tameike Tower, 7th Floor, 2-17-7 Akasaka, Minato-ku, Tokyo 107-0052, Japan

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Clifford Chance Law Office (Gaikokuho Kyodo Jigyo)

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TOKYO-1-280204