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補足事項 / Additional Information

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Participants other than the speakers are muted during this session.
途中ご質問などございましたら、画面下に表示されている以下Control BarのQ&Aボタンを押し、表示される入力欄へご質問内容をご入力ください。
Please use the Q&A button at the bottom of your screen to ask questions.
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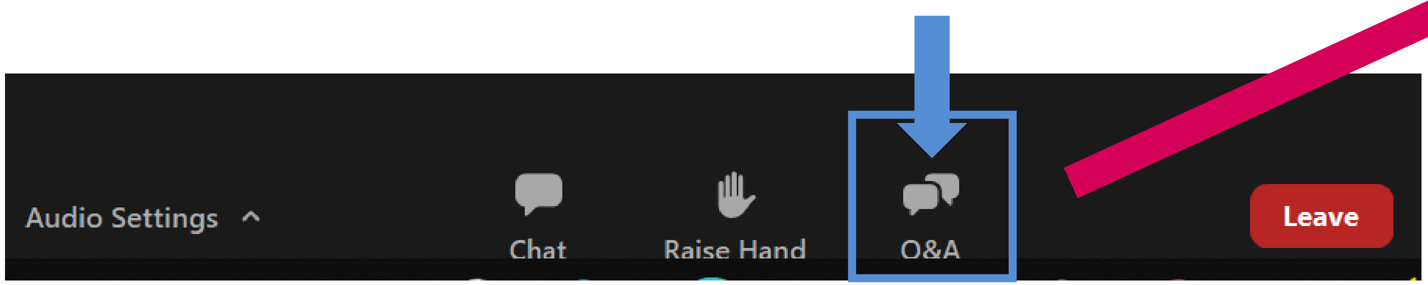

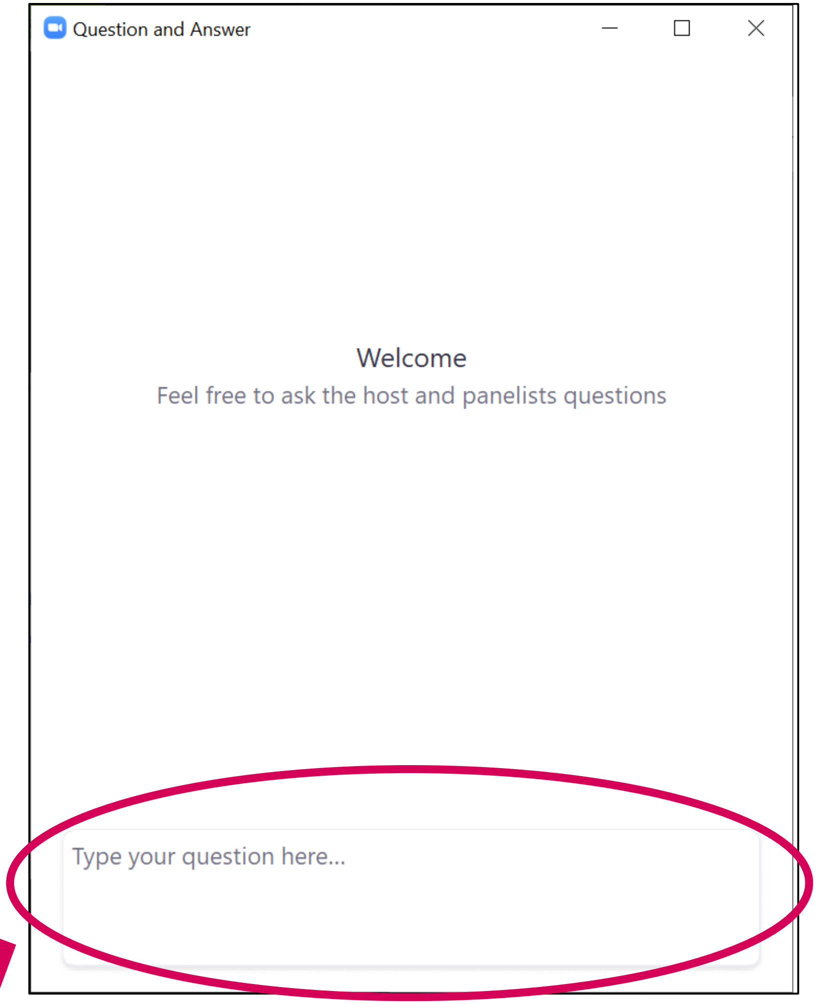

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Attendance Sheet

ATTENDANCE VERIFICATION CODE ________________ LOCATION _Tokyo, Japan_LOCATION FORMAT _Webinar_
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Course: Compliance in the Era of Remote Work
Format: Webconference
Instructor(s): Sugita, Hiroki
Yakura, Shinsuke
CA CLE Credits: 1 General - Participatory
NY CLE Credits: 1 PP

Date: 06/11/2020
Time: 12:30-1:30PM JST
Location: Tokyo (Tokyo, Japan)

Name	Sign In	Time In	Sign Out	Time Out	License State	Bar Number	Email
Taro Yamada		12:30 PM		13:30 PM	NY	XXXXXXXXX	t.yamada@orrick.com

必要事項を入力

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Page: 1 of 1

Upcoming Total Access Japan Hybrid Seminar / Webinar

November 15, 6:00pm- (Japan time)

Topic: **Open Source Software – Licensing and Sector Considerations (including AI and Web3)**

SAVE THE DATE!

U.S. VC VS JAPAN VC – KEY DIFFERENCES

日米のVC投資をくらべてみた

Topics

- Key Drivers for Choosing Location: U.S. vs Japan
- Incorporation Process
- Financing Terms
- Employment, and Compensation and Benefit

KEY DRIVERS FOR CHOOSING LOCATION: U.S. VS JAPAN

Key Drivers for Choosing Location: U.S. vs Japan

- Market
- Talent
- Investors
- Exit

Key Drivers for Choosing Location: U.S. vs Japan - Market

Market Considerations

- Is your product unique to a specific geography?
- Does one geography have a lower regulatory hurdle than others?
- Where do you have a "go to market" network already established?
- How soon will you want to expand into other geographies?

Key Drivers for Choosing Location: U.S. vs Japan - Market

Where is your Capital?

All Companies need Capital to thrive, but there are different types of Capital:

- Human Capital (quantity and quality)
- Social Capital (breadth and depth)
- Financial Capital (current and access to additional)

Identify your Human and Social Capital

- Where will you be able to hire talent? (Do you want to work in multiple geographies?)
- Where is your network?

Key Drivers for Choosing Location: U.S. vs Japan - Market

Where are your investors and what are they looking for?

- Market (threshold question – must swing for the fences or are base hits okay?)
- Product (innovative, simple, scalable within the market)
- Team
  - Human Capital (depth of experience individually and as a team, diverse backgrounds, likability)
  - Social Capital (what is the network you already have established)
- Ultimately, it is about whether they think they can get a big return on investing in your Company, though different investors have different expectations or thresholds for their return on investment.

Choosing Your Investor

The Good, the Bad, and the Ugly

Investor Type	Social Capital		Financial Capital		Notes:
	Breadth	Depth	Current	Potential	
Friends & Family	Low	Low	Low	Low	Initial money, nothing more
Angel / Super Angel	Medium	Low	Medium	Medium	Must understand motivations
Incubator / Accelerator	High	Low	Low	Low	Social network acceleration
Gov't / Foundations	Low	Medium	Medium	Medium	Slow moving, watch for strings
Venture Capitalists	High	Medium	High	High	Diversify your investors
Strategics (C-VCs)	Medium	High	Medium	High	Potential exit partner (good/bad)
Commercial Banks	Medium	Low	High	High	Purely financial interests (Debt)
Private Equity / IB	Medium	Medium	High	Extreme	Very late stage

Choosing Your Investor

The Good, the Bad, and the Ugly:

Additionally, there are different “Types” of Money – you will need to understand what your specific investor brings to the table:

Money Matrix

	"Passive"	"Active"
"Smart"	Good	Ideal
"Dumb"	Good	Avoid at All Costs

INCORPORATION PROCESS

Incorporation Process

US (Delaware*)

- Incorporation process is very simple and straightforward:
  - No need to issue shares at the time of incorporation.
  - Incorporation can be done in one day.
  - Flexible capital structure (FF Preferred, high vote / low vote stock, etc.).
  - Flexible consideration for shares (e.g., Intellectual Property, assets, etc.).
  - Certificate of Incorporation needs to be filed, but no rigid corporate registration system.
  - Must appoint service agent.

Japan

- Incorporation process has become more flexible over recent decades but not as much as in the U.S.:
  - Must issue shares at the time of incorporation.
  - Incorporation may typically take at least a week.
  - Difficult to do in-kind contribution (such as IP assignment).
  - Certain corporate matters need to be registered (and legal affairs bureau do examine the Articles of Incorporation to certain extent).

Incorporation Process

Challenges for Japan-based entrepreneur to incorporate in the U.S.:

- Opening a bank account in the U.S. without holding SSN may be difficult for Japanese entrepreneurs (may need extra time)
- VISA issues (acting as officer/director may complicate VISA application)

Some consider incorporating a holding company in the U.S. with an operating subsidiary in Japan, and management team eventually moves to the U.S.

Incorporation Process

Formal Requirements in the U.S.

- Companies will need to appoint a Board of Directors (size of the board may be dependent on the corporate statute of the state they are formed in).
- Officer positions are decided early on: CEO, President, CFO, COO, CTO, etc.
- Bylaws to be adopted with potential share transfer restrictions (requirements that board approval is obtained).

Formal Requirements in Japan

- Most companies start with companies without formal board of directors due to minimum seat requirements of directors and auditor.
- Officer positions are decided early on: typically representative director takes CEO role.
- No equivalence of bylaws, share transfer restrictions are in the Articles of Incorporation.

Incorporation Process

Other Requirements – U.S.

- Tax filings relating to shares must be made within 30 days of issuing the shares (this is the 83(b) election for US taxpayers).
- Board members and officers will get an "Indemnification Agreement" to protect them in the case they are sued. → Became available since 2021 in Japan but not yet widely used.
- Must "qualify" the company in each state that the company is operating in (other than its state of incorporation).
- Advisors and consultants will be compensated using equity, often at the time of the company's formation (at the same time founder shares are issued).

Incorporation Process (Founder Equity)

<u>Founder Equity</u>

- Typically use "Restricted Stock" – common stock with certain restrictions outlined below.
- Customary Vesting Terms for Founders ("reverse vesting") - best to have in place prior to a financing transaction.
  - 4 years vesting with credit for time served with double trigger acceleration on termination without cause in connection with or follow a change of control.
  - In Japan, given practical difficulty of forfeiture / repurchase of unvested shares, unvested shares will be often transferred to remaining founders pursuant to the founder's shareholders agreement.
- Right of First Refusal on Sale of Founder's Stock
- Lock-Up Agreement
- In the U.S., post-termination non-competes are very unusual, but non-solicits are common.

FINANCING TERMS

Key Financing Terms

- Valuation
- Control
- Exit Mechanics

Key Financing Terms - Valuation

Valuation Levers

- Pre-Money Valuation vs. Post Money Valuation (Equity vs. SAFEs)
- Pre-Money Capitalization – What goes into the denominator when calculating price per share in addition to outstanding shares (warrants, convertible notes, SAFEs, etc.).
  - In Japan, only outstanding shares or outstanding shares/options go into the denominator in most cases.
  - In the U.S., outstanding shares/options plus size of option pool after the financing plus convertible securities go into the denominator.
- Basic Calculation of Price Per Share → Pre-money Valuation / Pre-money capitalization = Price Per Share

Key Financing Terms - Valuation

Example 1 (Japan): $7M premoney valuation and $3M investment

Pre-Money Capitalization

– Founders	-	6M	-	85.7%	
– Employees	-	1M	-	15.3%	
– (Available Pool	-	2.5M	-	N/A)	
Total Cap	-	7M		Price Per Share:	$1.00

Post Money Capitalization

– Investors	-	3M	-	30%	
– Founders	-	6M	-	60%	
– Employees	-	1M	-	10%	
– (Available Pool	-	2.5M	-	N/A)	
Total Cap	-	10M		Price Per Share:	$1.00

Number of "Available Pool" will not be taken into account to calculate the price per share, only used to set a number of stock options the company can issue without consent of investors.

Key Financing Terms - Valuation

Example 2 (U.S.): $7M premoney valuation; $3M investment; Pool Increased to 20% on Post (dilution in pre)

Pre-Money Capitalization

– Founders	-	6M	-	61.2%	
– Employees	-	1M	-	10.2%	
– Available Pool	-	2.8M	-	28.6%	
Total Cap	-	9.8M		Price Per Share:	$0.7143

Post Money Capitalization

– Investors	-	4.2M	-	30%
– Founders	-	6M	-	42.86%
– Employees	-	1M	-	7.14%
– Available Pool	-	2.8M	-	20%
Total Cap	-	14M		

Number of "Available Pool" after the capitalization will be taken into account to calculate the price per share.

Key Financing Terms – Valuation

U.S. – Down Rounds

- Pay-to-Play may be implemented:
  - Convert all Preferred to Common (generally on 1:1 basis)
  - Those who purchase pro-rata amount of new financing can exchange common stock for preferred stock
  - Paying attention to current team ownership and incentives (refresh grants)
- Waiver of Anti-dilution typically solicited from current investors.
- Warrants can be used to adjust valuations or provide incentives for first movers.

Japan – Down Rounds

- Stronger resistance from existing investors to do down-rounds:
  - Use of convertible equity / bonds
  - Venture debts
  - No voting adjustment is available in practice
- Pay-to-Play is rarely used.

Key Financing Terms - Control

How the Company is Controlled

- The baseline in the US is that the Majority of Shares elects all of the Board of Directors (cf. cumulative voting in Japan) → so Voting Agreement is used.
- In the U.S., the Board of Directors appoints the Officers and manages high level issues and the Officers manage the day-to-day business of the Company.
- The Role of shareholders remain strong in Japan if the company does not have a formal "Board of Directors".
- In Japan, board of directors = management team, which is still true in the U.S. in early-stage companies (though there is still a formal board required in US).
- Protective Provisions (Covenants, Statutory, Certificate of Incorporation) – gives investors veto rights → be aware of different statutory voting thresholds in Japan.

Key Financing Terms - Control

Protective Provisions

- Focus on the voting threshold (whose consent do you need).

  Watch out for Veto Power held by multiple stockholders (precedent)

  → Seen more often in Japan (multiple layers and/or specific investors)
- Consider Board Carve-Outs (i.e.: if unanimous board approves, separate stockholder consent may not be required).
- Protective Provisions can slow the management of the Company.
- U.S.: Protective Provisions are <u>stronger</u> than negative covenants in other agreements ("*ultra vires*" acts under DE are "voidable").
- In Japan, protective provisions are often in the shareholder's agreement only, but not in the Articles of Incorporation (cf. rigid procedures to hold shareholders meeting).

Key Financing Terms - Control

Protective Provisions (examples in U.S.)

Company must receive consent of Preferred holders (majority or super majority) for the following actions (differs from company to company) :

- Amend Certificate of Incorporation
- Change of Control Transaction
- Repurchase Shares / Issue Dividend
- Authorize any senior security
- Grant options beyond a certain limit
- Incur Debt beyond a certain limit
- Acquisitions of shares of another entity (or create a subsidiary)
- Enter any transaction with officers or directors

Key Financing Terms - Control

Board of Directors

- Board Composition (how many and who designates)
- Limitations on rights to designate board members:
  - Minimum share holding
  - Employment with the Company
- Voting Agreement – obligates all stockholders to vote for the designees of specific stockholders
- Board Observer Rights → No fiduciary duties, consider limitation of attendance (less common in Japan)

Key Financing Terms - Control

Board of Directors – Mechanics

- Board Meeting Frequency
  - Japan - typically monthly, once per quarter at minimum
  - U.S. - never monthly; at most, once per quarter
- Meeting Mechanics and Agenda – U.S.
  - Led by Chief Executive Officer (unless chairman has been appointed, which is rare)
  - Agenda – Executive Summary, Engineering/Product Update, Sales and Marketing Update, HR Update, Finance Update, Legal Update, then Corporate approvals (option grants, approve prior minutes, etc.).
  - Ends with Executive Session (Board and executive officers with counsel)

Key Financing Terms – Exit Mechanics

Preferred Stock Liquidation Preference

- Upon a Change of Control, holders of preferred stock will receive:
  - "Preference" – they get paid first (down-side protection). (Stack vs. Pari Passu)
  - "Participation" – Having your cake and eating it too (less common in the U.S., more common in Japan).
  - Cap on Participation – limiting the damage.
- Think through the potential exit scenarios and try to get incentives to line up as much as possible (minimize the "Zone of Indifference").

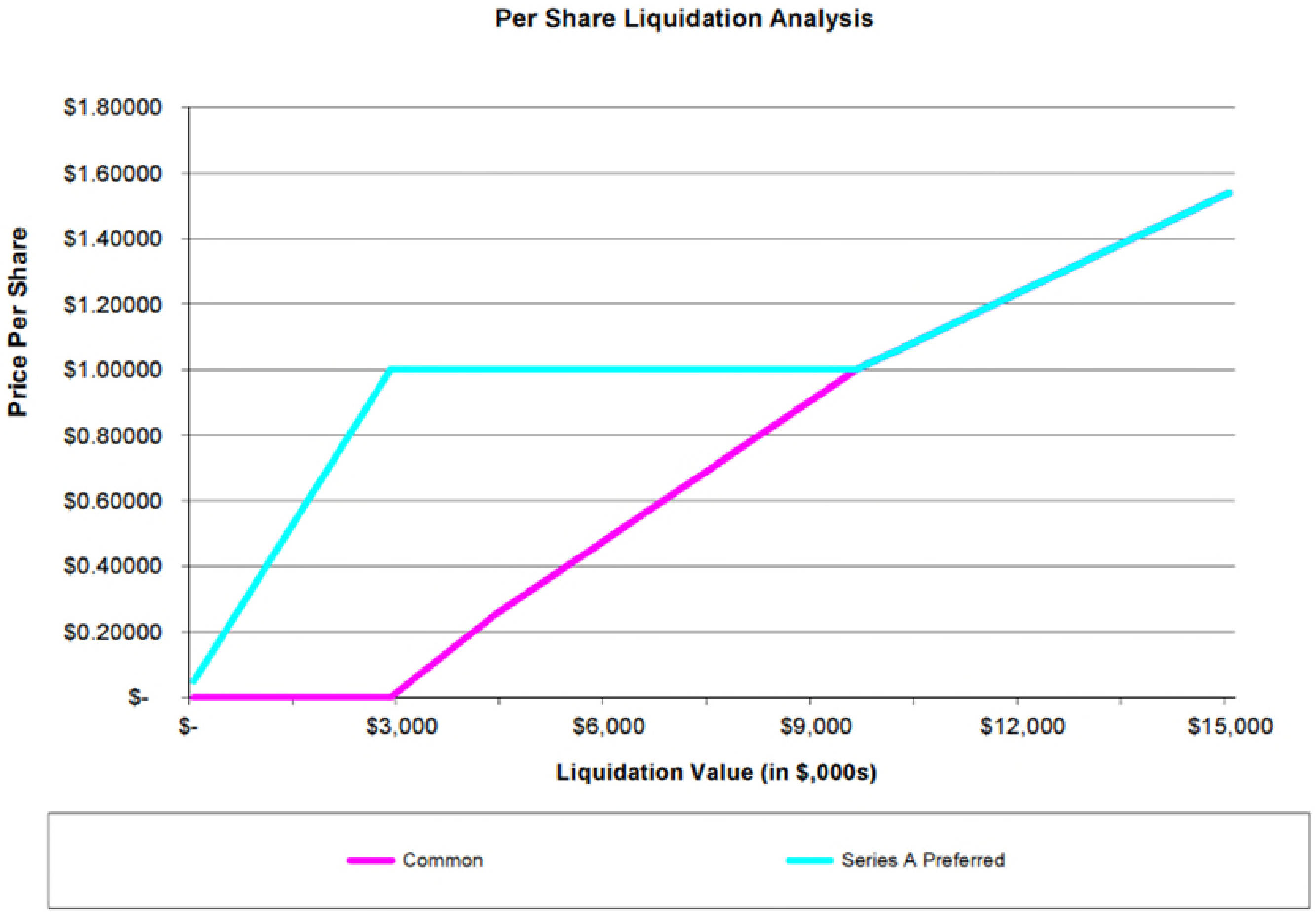
Key Financing Terms – Exit Mechanics

Examples Assuming the following cap table:

Class/Series of Stock	Shares Outstanding	% of Fully Diluted Capitalization	Liquidation Preference per Share
Common Stock	7,000,000	70%	$0
Series A Preferred Stock	3,000,000	30%	$1.00
Total Shares:	**10,000,000**		

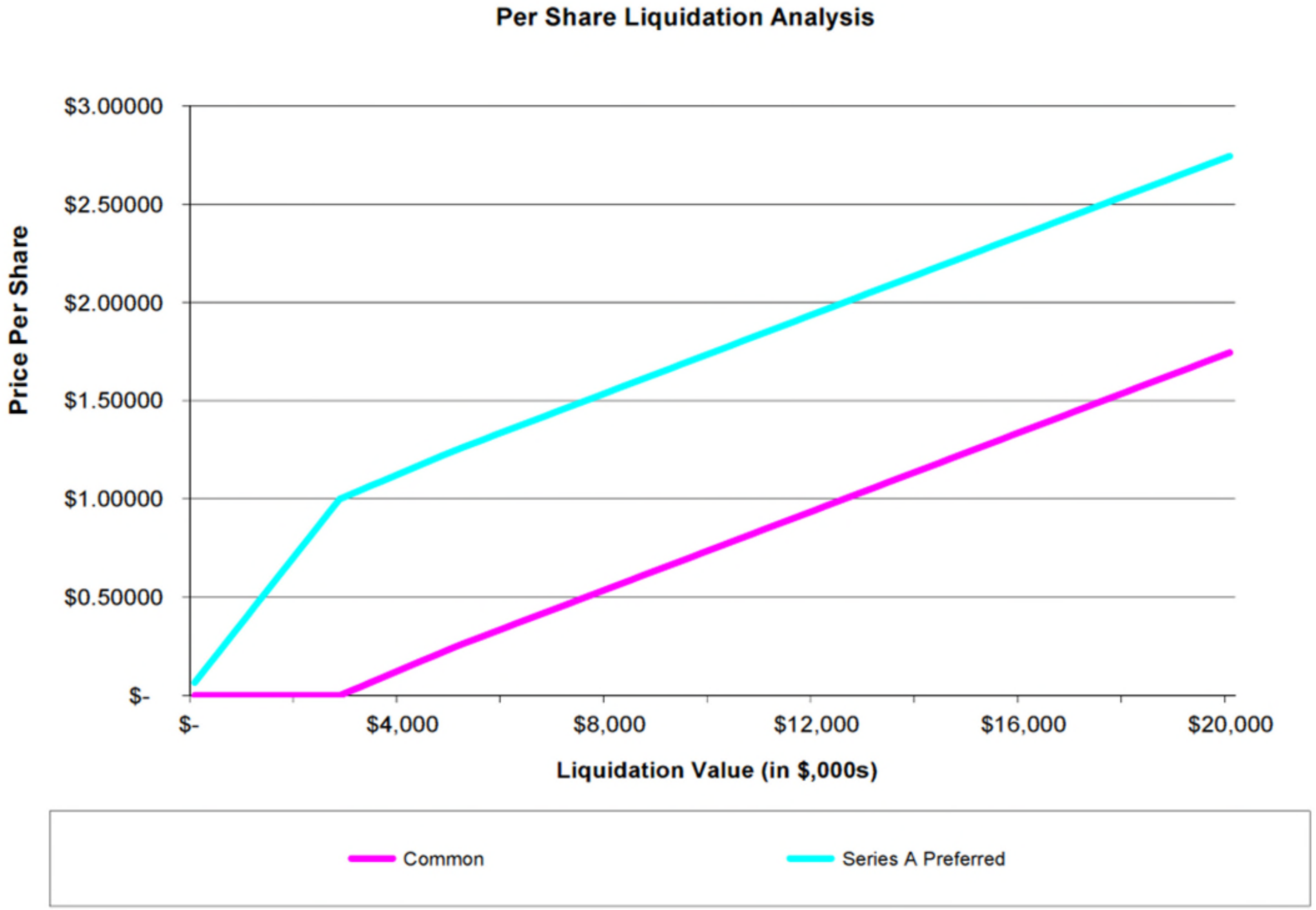
Key Financing Terms – Exit Mechanics

Liquidation: 1x, non-participating



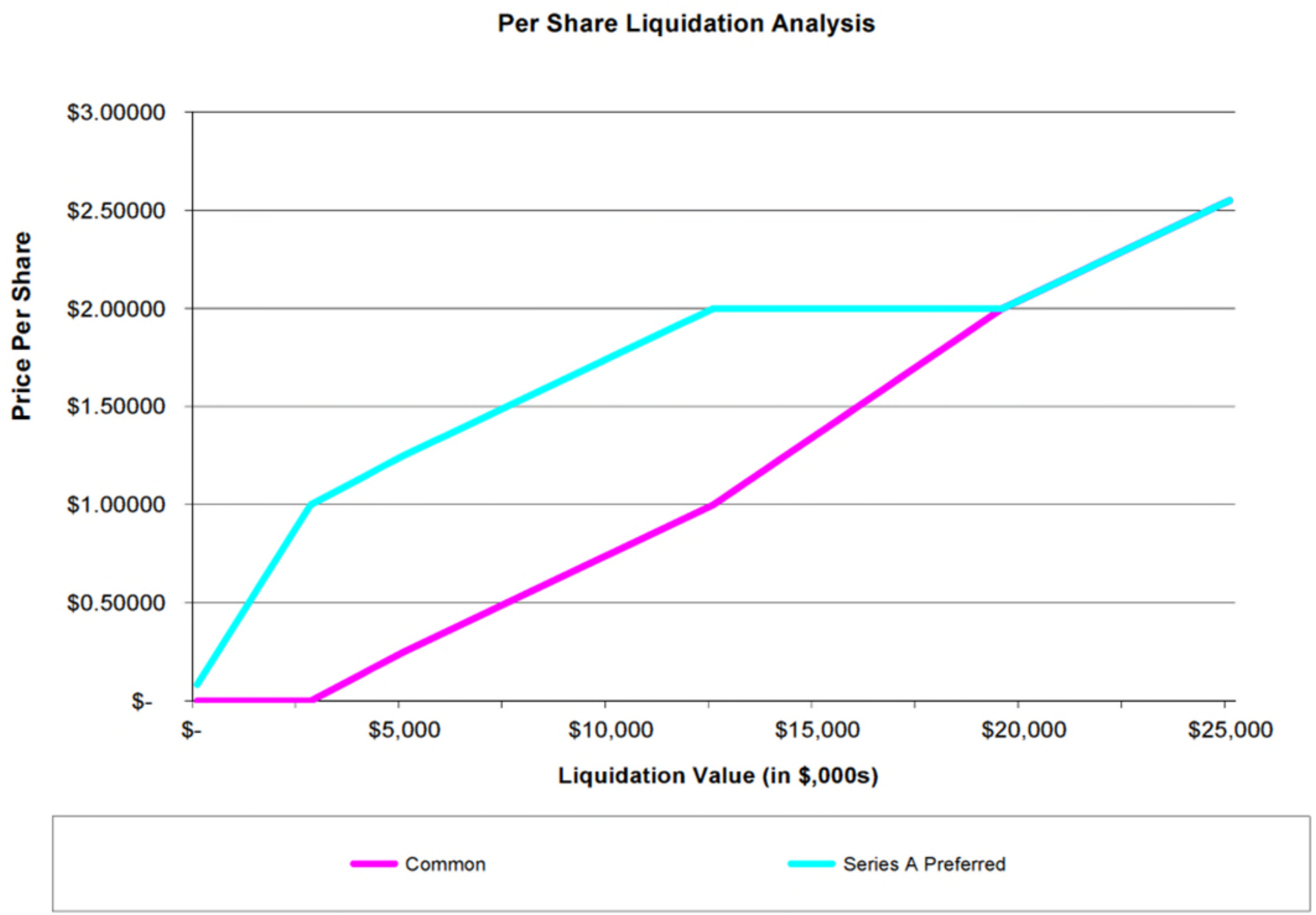
Key Financing Terms – Exit Mechanics

Liquidation: 1x, Fully-Participating



Key Financing Terms – Exit Mechanics

Liquidation: 1x, Fully-Participating with 2x Cap



* Additional examples attached.

Key Financing Terms – Exit Mechanics

Additional Examples of Liquidation Preference

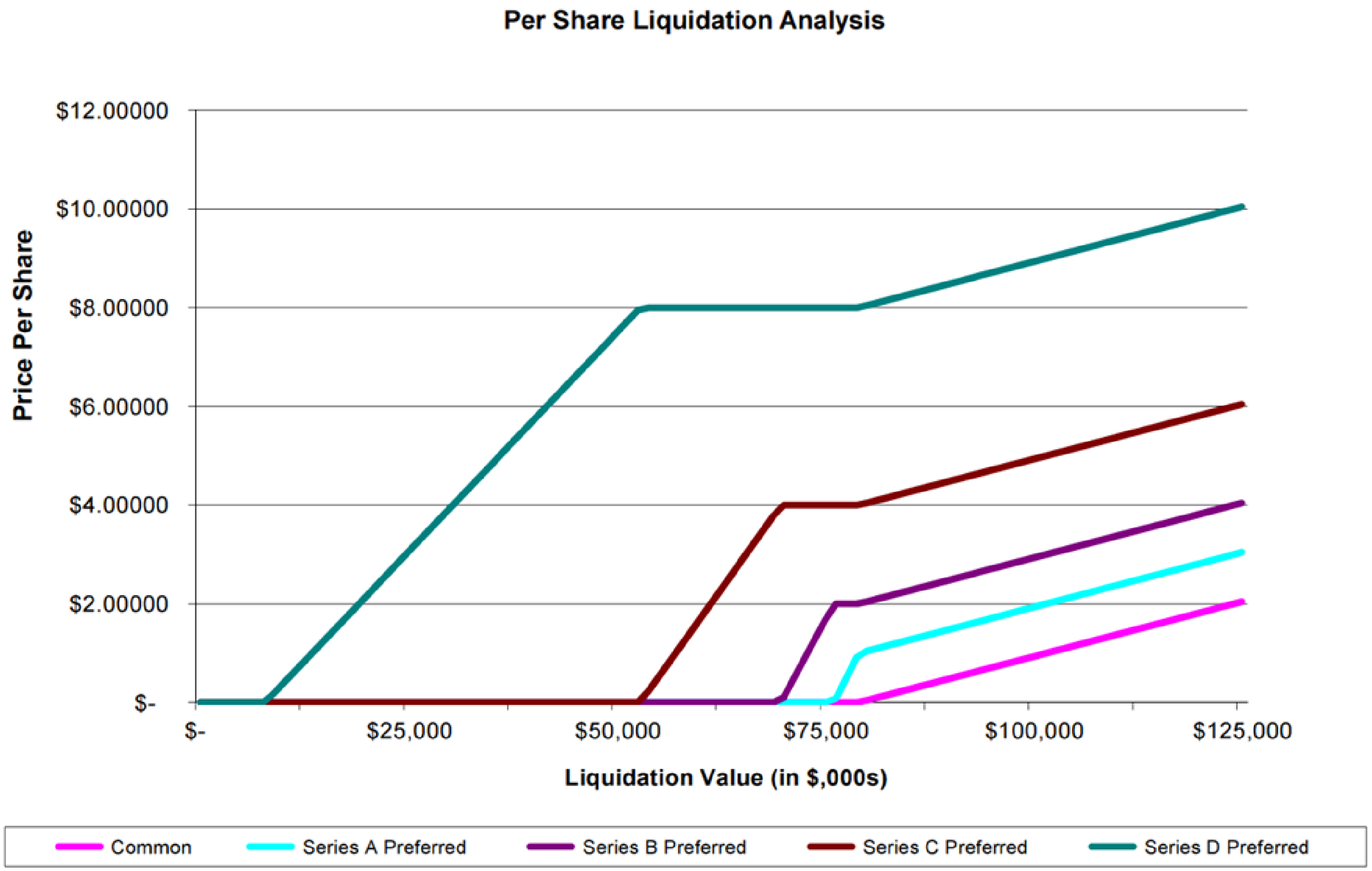
The Following Slides assume the Company has raised funds through a Series D Financing, with the B, C, and D each raising funds at 2x the valuation of the prior round for 25% of the company at each fundraise. The Cap would be as follows:

- Common Stock - 6,500,000 shares (assume no options)
- Series A Preferred - 3,000,000 shares ($1.00 per share)
- Series B Preferred - 3,166,667 shares ($2.00 per share)
- Series C Preferred - 4,222,222 shares ($4.00 per share)
- Series D Preferred - 5,629,630 shares ($8.00 per share)

(implied Valuation at Series D - $180,148,148)

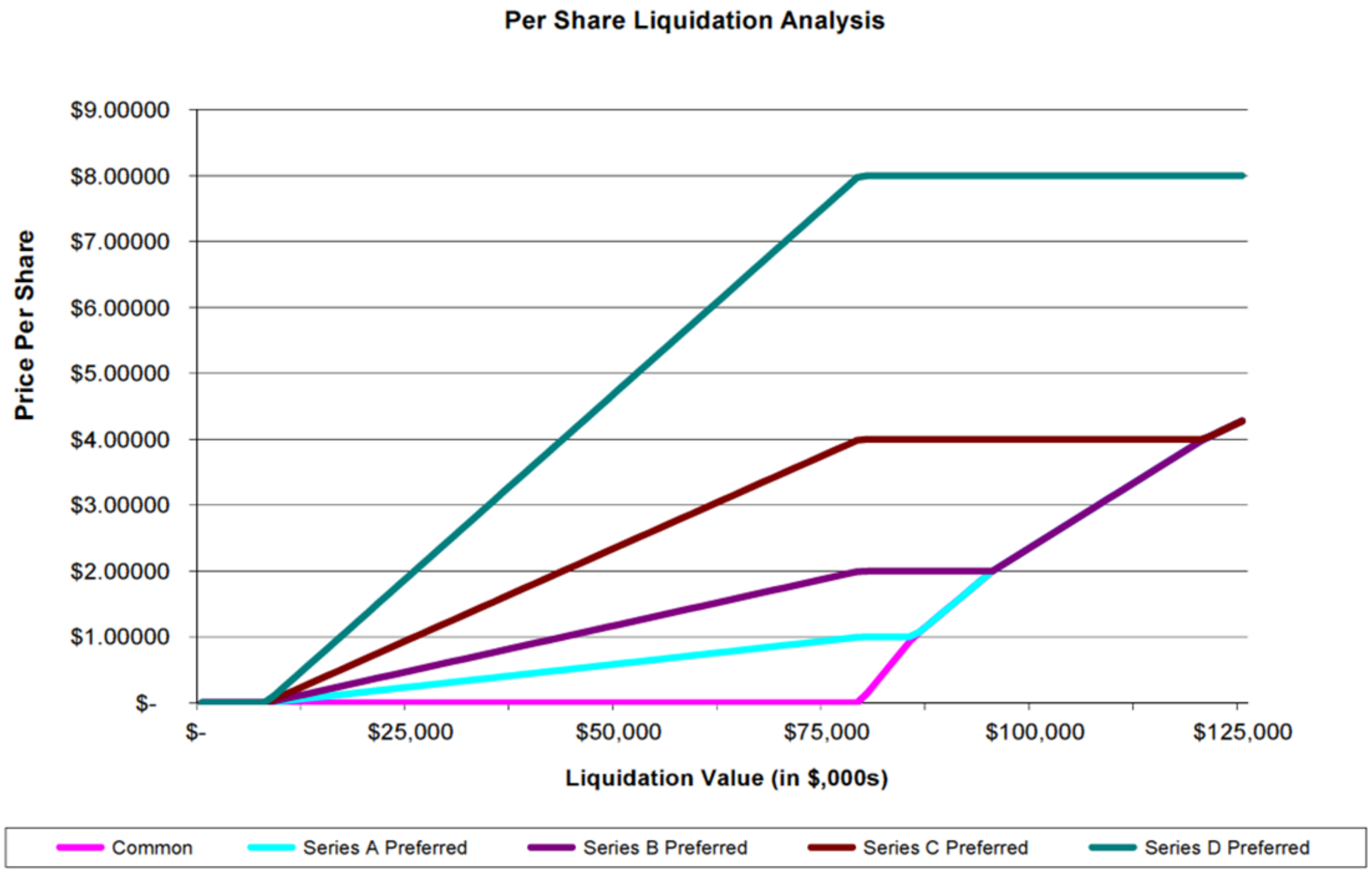
Key Financing Terms – Exit Mechanics

<u>Liquidation: Multiple Series – Senior with higher Preference, 1x, Fully-Participating (common in Japan)</u>



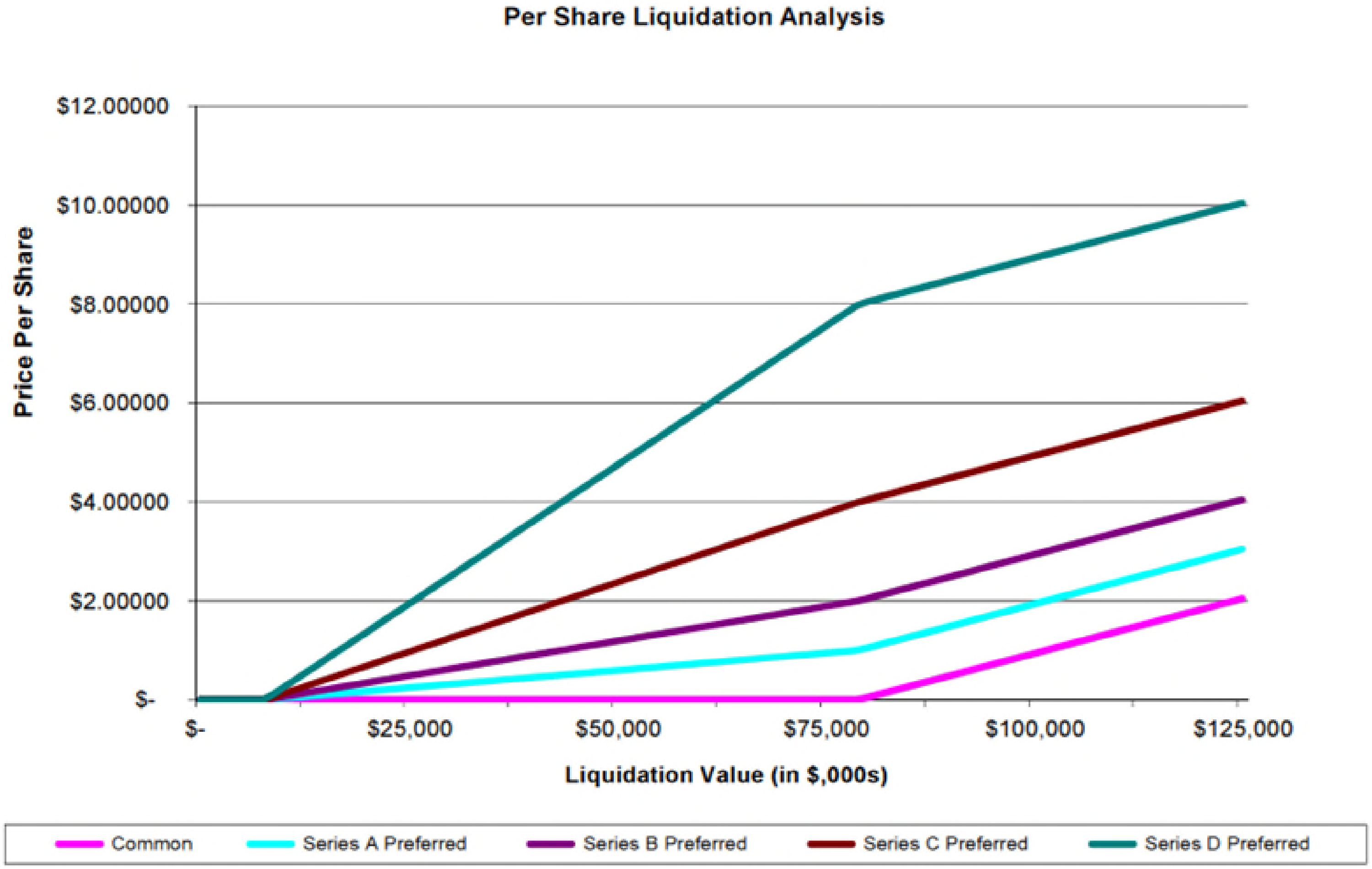
Key Financing Terms – Exit Mechanics

Liquidation: Multiple Series (Pari Passu), 1x, Non-Participating (common in the U.S.)



Key Financing Terms – Exit Mechanics

Liquidation: Multiple Series (Pari Passu), 1x, Fully-Participating



Key Financing Terms – Exit Mechanics

Japan

- IPO is still the dominant exit path in Japan (are investors worse off?).
- Historically, given the inflexibility of consideration and procedures for merger, majority of acquisitions were made through share purchase in Japan.
- There may be more mergers going forward after introduction of share delivery (*kabushiki kofu*) under the Companies Act.
- Challenge: most stock options do not address exits through share sales.
- More and more best effort IPO obligations with M&A exits.

U.S.

- Most exits are through M&A.
- Most M&As are done through a "reverse triangular merger" (acquiror creates a subsidiary that acquires target using parent shares as consideration).
- Asset Sale are also an option (depending on tax situation) – less popular than merger.
- Share Acquisition is third possibility – though rare due to 100% consent requirement.
- IPO generally only for large companies (difficulty of public offerings in the U.S.)

EMPLOYMENT, AND COMPENSATION AND BENEFIT

Employment, and Compensation and Benefit

Japan

- No “at will” employment in Japan.
- Japanese law requires that termination of regular employment shall be considered objectively, deemed reasonable, and appropriate upon social convention, which is read rigidly in light of Japanese judicial precedent.
- Use of "fixed-term" employees / probation period.

U.S.

- "At Will" employment in the U.S. is on a state-by-state basis (based on where the employee is, not where the Company is formed).
- Where "at will" employment exists, termination for no reason is acceptable, but termination for "bad" reason is not (for example - discrimination).
- Fixed-term employees are very unusual. Occasionally, U.S. companies will hire the candidate as a consultant for a limited period before extending employment offer.

Employment, and Compensation and Benefit

Stock Option in Japan

- Practical difficulties of timely issuances (shareholders meeting, delegation to the Board of Directors).
- Registration is necessary for each issuance.
- NTA's announcement on trust-type of stock options and fair value.
- Vesting is becoming more common in recent years.
- Becoming more common but often granted to employees without strategic thoughts.

Stock Option in the U.S.

- Controlled at the Board level (no stockholder consent is necessary).
- Registration is not required, though securities law compliance is on a state-by-state basis.
- Vesting is typically a 4-year vesting period with 1 year cliff.
- Double Trigger Acceleration (if any).
- May be early exercisable (not common).
- Options are a very common method of compensation.

KEY TERMS – EVERYTHING ELSE

Key Terms – Everything Else

Redemption Rights (not common in U.S., still common in limited space in Japan)

- Force the Company to repurchase the Preferred Stock.
- Return is often similar to liquidation preference or original purchase price but with a hurdle.
  - Timing for redemption – the further out the better (5-7 years)
  - Triggers for calling a redemption – the more difficult the better
  - Installments – the more the merrier
  - May Trigger Debt Treatment for Accounting
- For U.S. investors, a Redemption Right makes the company in question look like it was in distress (i.e. it is a bad sign).

Key Terms – Everything Else

Conversion (Preferred Stock into Common Stock)

- Conversion is on a 1 to 1 basis (subject to adjustment)
- Optional Conversion
  - Preferred stock is convertible into common stock at any time at the option of the holder.
- Mandatory Conversion
  - Triggers for mandatory conversion – IPO or vote by the preferred stock.

    → Timing of mandatory conversion is earlier in Japan due to IPO practice.
  - Percent of preferred vote necessary to trigger conversion is subject to negotiation.
  - Watch out for series veto right.

Key Terms – Everything Else

Voting

- Preferred Votes with Common Stock on all matters on an as-converted to Common Stock basis, but with the exception of protective provisions and changes in the Certificate of Incorporation that impact a particular class or series.
- In principle, fractional voting is not permissible in Japan.

Pay to Play Provisions

- Requires investors to participate in future fundraises or risk having their Preferred Stock converted into Common Stock.
- Triggers for activating the pay to play could be based on fundraise amount or based on a vote.
- Consequences for failure to pay typically consist of losing liquidation preference and other rights.
- Not typical in the U.S., as conversion feature used to implement a Pay to Play
- Technically possible but rarely seen in Japan.

Key Terms – Everything Else

Registration Rights in the U.S.

- Common Rights – Don't spend too much time negotiating these.
- Demand registration = forcing function for your company to go public.
- S-3 registration = short form registration for eligible issuers.
- Piggyback registration = investors tagging along company registration.
- Lock-up = absolutely necessary for company to retain underwriter.

Registration Rights in Japan

- No concept of registration in Japan IPO, so shareholders agreement typically provide only best effort obligations of the company/founders to do IPO during the agreed timeframe.

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