Key Takeaways

Skadden

Cross-Border M&A Conference 2019

クロスボーダー M&Aコンファレンス2019

Developments and Trends in US and Japanese M&A

If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

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On May 6, 2019, Skadden hosted the Cross-Border M&A Conference 2019, titled "Developments and Trends in US and Japanese M&A." Key takeaways from the two panel discussions are summarized below.

US-Bound M&A Deals

The panelists were **Akira Kumaki**, Skadden M&A partner; **Michael J. Mies**, Skadden corporate partner; **Patrick G. Rideout**, Skadden litigation partner; and **Donald L. Vieira**, Skadden CFIUS and cybersecurity partner. Skadden corporate partner **Kenji Taneda** moderated the discussion.

Mr. Kumaki explained that the outlook for Japanese outbound M&A has continued to strengthen, with more than 20 $1 billion-plus deals per year being the new norm. Similarly, "megadeals" (*i.e.*, transactions over $10 billion dollars), such as Takeda-Shire and Softbank-ARM, also have become more common. Mr. Kumaki said that, in addition to an increase in transaction size, the participants engaging in cross-border acquisitions also have become more diverse. Until recently, large, Tokyo-based multinational corporations engaged in the bulk of outbound M&A activity, but Mr. Kumaki pointed to the trend of midsized, non-Tokyo based, traditionally domestic companies branching out into cross-border acquisitions. A driving factor for such activity has been the shrinking domestic Japanese market and the need for new markets/customers abroad. The IT, pharmaceutical and financial services sectors, in particular, have seen robust deal activity.

The reception of Japanese outbound M&A transactions in the media, and within Japanese acquirers themselves, has not always been positive, however. Mr. Kumaki pointed to the recent trend of citing impairment of goodwill as evidence that a buyer has overpaid. In light of recent negative press regarding such impairment charges in the Japan Post-Toll Holdings transaction, the boards of Japanese companies have often sought to limit the impact of impairment as much as possible. This has led to instances in which Japanese companies in an auction situation cannot set forth a competitive price.

Another recent trend has been the rise of representation and warranty insurance, particularly in competitive auction transactions with private equity sellers. While the purchase of representation and warranty insurance by Japanese acquirers was nearly unheard of three to four years ago, today nearly half of all transactions involve at least the discussion of such insurance. Acquirers need to be mindful, Mr. Kumaki explained, of common exclusions in coverage under such insurance (*e.g.*, environmental, tax and anti-corruption laws). In competitive bid situations, though, sellers often frame the purchase of representation and warranty insurance as a prerequisite for a bidder to participate in the process.

That being the case, and in light of the continued growth of Japanese outbound M&A, insurance has become more and more prevalent even in Japan.

Mr. Vieira explained the landscape with respect to CFIUS in light of the amendments undertaken pursuant to the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) and how such changes could impact Japanese outbound M&A activity. While rulemaking is underway and the regulatory regime will remain in flux until the end of this year, new mandatory filings required by FIRRMA mean that CFIUS will be involved in the evaluation of every cross-border U.S.-targeted transaction. In particular, FIRRMA will require mandatory filings for deals relating to certain sensitive technologies. In the event that an acquirer fails to make such a mandatory filing, the government may not only cancel the transaction but also impose fines of up to the transaction value. Mr. Kumaki and Mr. Vieira agreed that the new requirement for mandatory filings, as well as the rise of CFIUS as a tool for U.S. trade policy, could put Japanese acquirers on better footing versus rival Chinese acquirers in a competitive auction situation. However, the panel also agreed that the typical four-to-six-month review period required by CFIUS would put Japanese acquirers at a disadvantage in instances where rival, U.S.-based buyers were participants in a similar context.

One potential bright spot identified by Mr. Vieira was that the short-form declaration process introduced by FIRRMA may eventually allow for clearance of less sensitive transactions within 45 days (though, thus far, this process has not been implemented). Mr. Mies added that given the uncertainty around the new CFIUS regime, allocation of risk between buyers and sellers for CFIUS matters was also unsettled. While use of termination fees in the event of buyer failure to close due to CFIUS has recently been deemphasized in favor of "hell or high water" covenants, the level of mitigation required by CFIUS in certain recent transactions has also made such covenants less palatable. Mr. Kumaki and Mr. Taneda also highlighted the need for thoughtful, nuanced legal advice on CFIUS matters given the complexity of the regulatory scheme and potential negative impact on Japanese acquirers in competitive situations. Finally, Mr. Vieira pointed to certain areas in which CFIUS has been particularly active and has increased staff and budget, namely, scrutiny of ultimate beneficial ownership that has implicated seemingly "U.S." companies, collection of data regarding the work potential acquirers do in sanctioned countries, and increased audit and enforcement of mitigation arrangements.

Mr. Rideout provided background and recent developments regarding the litigation surrounding Fujifilm's aborted transaction to acquire a majority interest in Xerox Corporation. The Supreme Court of New York's speedy decision to grant shareholders an injunction to block the transaction was noteworthy in that, when analyzing the Xerox board's actions, the court declined to apply the largely deferential business judgment rule in favor of the much more stringent entire fairness standard. Such standard of review places the burden of proof on defendants to show fairness not only in terms of price but also in process. The New York Appellate Division overturned the lower court's decision, applying the business judgment rule and dissolving the injunctions against the deal. Nevertheless, the transaction had already been abandoned via settlement between the shareholders and Xerox after the lower court decision, and the CEO and five other directors had already resigned and been replaced by a CEO and new directors friendly to the plaintiff shareholders. Mr. Rideout explained how the litigation had brought continued attention to the New York Commercial Division's status as a "leading" business court, as well as the impact U.S. discovery played in the lower court's decision and differences in how New York and Delaware evaluate board members' conflicts of interest. Finally, the litigation brought renewed attention to the impact of shareholder activism (highlighted by the actions of Xerox shareholders Carl Icahn and Darwin Deason in opposing the Fujifilm transaction), which has recently become a trend in Japan as well.

Japan-Bound M&A Deals

The panelists were **Mitsuhiro Kamiya**, Skadden M&A partner; **Kenton J. King**, Skadden corporate partner; **David Rosewater**, managing director, Investment Banking Division at Morgan Stanley; **Vikram Suresh**, principal at Blackstone Private Equity; and Mr. Taneda.

Mr. Kamiya launched the discussion by providing a brief history of shareholder activism in Japan, from the corporate raiders of the 1980s and *sokaiya* (individuals that would harass company personnel at shareholder meetings in order to extract bribes) through the failed hostile takeovers and insider trading scandals of the 2000s. Approaching the present day, Mr. Kamiya explained how the Japanese government has encouraged both greater consideration of shareholder interests by boards/management and activity by institutional shareholders through the institution of the Corporate Governance Code (2015, amended 2018) and Stewardship Code (2015, amended 2017), respectively. Mr. Kamiya also provided background regarding procedural matters that shape how shareholder activism works in practice, such as shareholder proposals and proxy contests. The nature of activist shareholder demands go hand in hand with the rise of private equity activity in Japan, Mr. Kamiya explained, through an increase in shareholder pressure on companies to, *e.g.*, divest noncore businesses, appoint directors representing minority shareholders and other similar efforts. While private equity had a negative image in Japan for a considerable time, since 2010 activity has gradually increased due to the perception that private equity will provide management with necessary resources and make investments with a longer time horizon.

Mr. Rosewater explained that shareholder activism remains at high levels worldwide, with Asia in particular witnessing a record high 112 activist campaigns in 2018. In Japan, various factors, including government-led emphasis on corporate governance, the trend of increased U.S. and global institutional investor participation, and the perception that Japanese companies are undermanaged have also led to a significant increase in activist activity. Mr. Rosewater continued to explain that Japan has seen substantial shareholder activism activity in the consumer goods, services, financial and technology sectors. This is similar to the U.S., with the notable exception that consumer goods companies see a far greater share of activist activity in Japan. Unlike the U.S., however, activist activity in Japan tends to be focused on a narrower set of demands — namely, balance sheet activism (*e.g.*, proposals trying to deter the hoarding of cash, underleveraged or "lazy" balance sheets, inefficient treatment of subsidiary cash and the like), board-related activism (*e.g.*, seating of more internationally oriented directors) and M&A activism (*e.g.*, criticism of the sale price for divestiture of subsidiaries).

Mr. Kamiya and Mr. Rosewater discussed some of the differences between Japanese and U.S. responses to shareholder activism. Whereas in the U.S. companies realize the need to respond to activist demands expeditiously and in a serious manner, in Japan companies may hesitate to react quickly when approached. In the event of a cost-cutting request, for example, a U.S. company may respond quickly while a Japanese company may simply respond that it will "grow into" its costs. Mr. King concurred that U.S. companies are much more familiar with activist demands and often proactively identify potential activists, discuss theoretical demands and develop strategies for response. The panel members agreed that the tide is beginning to turn in Japan and that more and more companies are beginning to familiarize themselves with shareholder activism and the need for appropriate preparation and proactive strategy.

Mr. Suresh provided background information regarding aspects of private equity generally and focused on Blackstone's philosophies of a long-term-oriented approach toward value creation and capital allocation, and active partnership with and support for management teams. With respect to private equity activity in Japan in particular, Mr. Suresh explained that although private equity activity in Japan has increased in recent years, transaction volume still is small relative to that in the U.S. and Europe. Notably, from 2014 to 2018, Japan averaged approximately 75 transactions with approximately $5 billion in value, annually. However, Mr. Suresh did point toward an evolution of the Japanese private equity market in terms of transaction frequency and type. Namely, the rising trend of corporate divestitures (40 in 2018, approximately three times the number in 2015) has led to a number of new opportunities for private equity investors. Furthermore, the increased availability of acquisition debt financing vis-a-vis other parts of Asia, as well as the previously mentioned government initiatives to promote increased private equity investment, also have fostered increase private equity activity in Japan. (Statistics source: Bain & Company, Preqin; statistics exclude Bain-Toshiba Memory transaction in 2017.)

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