

chain in public filings both before and after the de-SPAC transaction closed. The court concluded that at least one of the defendants' alleged misstatements about the company's battery cell suppliers was not protected by the PSLRA safe harbor for forward-looking statements, and allowed that part of the plaintiffs' Section 10(b) claim to proceed. The court also determined that the plaintiffs adequately alleged that two officers of the target company (who continued as officers in the post-merger entity) acted with the requisite scienter "[b]ased on the importance of battery cells" to the company (which were a "daily focus") and the officers' repeated statements about the company's supply agreements. The court, however, concluded that the plaintiffs' claims under Section 14(a) of the Exchange Act for alleged misstatements in the proxy statement for the de-SPAC transaction were derivative in nature rather than direct, and dismissed those claims due to the plaintiffs' failure to adequately plead demand futility.

### Skillz, Inc.

Most recently, in *Jedrzejczyk v. Skillz, Inc.*,<sup>4</sup> shareholders in a mobile gaming technology company that went public via a SPAC brought securities claims against the company and certain of its current and former officers and directors (among others) for alleged misstatements about the company's existing business and future prospects. The court dismissed all of the Exchange Act claims without prejudice, finding that some of the alleged misstatements were protected by the PSLRA's safe harbor for forward-looking statements, others were non-actionable puffery, and that the plaintiffs had failed to adequately plead that other alleged misstatements were actually false. The court also concluded that the plaintiffs had failed to adequately plead scienter, finding that the inference of fraudulent intent was not as compelling as opposing inferences.

### Two Key Takeaways

1. While the motion-to-dismiss decisions in *Alta Mesa*, *QuantumScape* and *Romeo Power* could be viewed as an unfavorable trend for participants in de-SPAC transactions, the *Skillz* decision shows that investors still have a significant pleading burden for federal securities claims related to such transactions.
2. There are dozens of SPAC-related securities cases in which motions to dismiss have not yet been decided. Market participants should continue to monitor those cases for additional developments, including the success of the types of falsity and scienter-based arguments that prevailed in the *Skillz* decision.

*The views and opinions set forth herein are the personal views or opinions of the authors; they do not necessarily reflect views or opinions of the law firm with which they are associated.*

### ENDNOTES:

<sup>1</sup>No. 4:19-cv-00957 (S.D. Tex. Apr. 14, 2021).

<sup>2</sup>No. 3:21-cv-00058 (N.D. Cal. Jan. 14, 2022).

<sup>3</sup>21-cv-03362 (S.D.N.Y. June 2, 2022).

<sup>4</sup>21-cv-03450 (N.D. Cal. July 5, 2022).

## THE EVOLVING MARKET FOR CORPORATE CONTROL IN JAPAN

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The past decade has been a period of significant change in the Japanese M&A market. Not only has the aggregate number and value of M&A transac-

tions dramatically increased, but aspects of the market that were previously absent or extremely rare, including contested transactions, activist-spurred sales processes and divestitures, and significant private equity activity, have now firmly taken root. This article will review the factors that have contributed to this rapid development and increased sophistication of the market for corporate control in Japan, and explore the remaining challenges that hinder the continued development of a robust and effective M&A market.

### **Economic and Corporate Governance Trends Underpinning the Japanese M&A Market**

Japan has historically been characterized as having exceptionally low levels of domestic and inbound M&A activity, in particular for sales of corporate control of listed companies as well as sales of significant corporate assets.<sup>1</sup> Japan's total M&A by value averaged around 2% of Japan's GDP between 2015 and 2020, lagging far behind other developed economies such as the United States.<sup>2</sup> In contrast to Japanese companies' enthusiasm for overseas acquisitions, Japan's share of global inward foreign direct investment in 2020 was a paltry 1%, compared with 31.3% for developed economies overall,<sup>3</sup> and it is estimated that only 14% of foreign direct investment into Japan takes the form of inbound M&A, as opposed to 80% for rich countries more generally.<sup>4</sup> This past aversion to M&A has been ascribed to a variety of factors, including the Japanese lifetime employment system, cheap financing which allowed stagnant firms to survive without selling unprofitable assets and cross-shareholdings among listed firms which insulated management from pressure to improve their return on equity.

This low economic metabolism from a lack of M&A has become particularly acute as Japan faces

a challenging demographic environment, with its population having declined by approximately 950,000 to a total of 126 million people between 2015 to 2020,<sup>5</sup> then falling precipitously by another 644,000 in 2021 due to the impacts of the COVID-19 pandemic and related border restrictions.<sup>6</sup> Japan's population is expected to continue to decline to 110 million by 2040 and 88 million by 2065.<sup>7</sup>

In order to achieve economic growth despite these demographic and cultural headwinds, the 2012-2020 administration of former Prime Minister Shinzo Abe identified in its 2013 Japan Revitalization Strategy improved corporate governance, and an accompanying increase in M&A activity, as the key component of its "third arrow" for spurring economic growth.<sup>8</sup> As part of this "third arrow," the Japanese government successfully enacted certain amendments to the Companies Act of Japan and introduced the Stewardship Code in 2014 and the Corporate Governance Code in 2015,<sup>9</sup> which was followed by the introduction of the Fair M&A Guidelines in 2019.<sup>10</sup> These changes have led to increased ownership and engagement by institutional shareholders, greater numbers of independent directors and decreased cross-shareholdings at Japanese public companies.<sup>11</sup> Prime Minister Fumio Kishida, who took office in October 2021, has called for a "new form of capitalism," which appears to be on its face an endorsement of stakeholder capitalism—however, in practice, it has yet to lead to any significant reversals of the policies of his predecessor.<sup>12</sup>

As a consequence of these corporate governance reforms, the proportion of Tokyo Stock Exchange-listed companies with at least one independent director has shown a remarkable increase from 34.3% in 2012 to 95.6% in 2020,<sup>13</sup> with the proportion of listed companies reviewed by ISS with at

least 50% independent directors increasing from 5% in 2016 to 15% in 2021.<sup>14</sup> This has coincided with other improvements, including a decrease in so-called “parent-subsidary” listings, where a publicly-listed company is controlled by a parent company that is also publicly listed, from 9.5% in 2012 to 8.0% in 2020,<sup>15</sup> and a decrease in listed companies with anti-takeover measures from 19.4% in 2012 to 7.7% in 2020.<sup>16</sup>

These reforms have also accelerated a long-term trend in the decrease of cross-shareholdings, where Japanese companies hold shares of other Japanese companies for strategic reasons such as historical group affiliations or supplier-customer or lender-borrower relationships. The overall level of cross-shareholdings by listed companies has declined from almost 35% in the early 1990s (over 50%, if shareholdings by insurance companies are included) to 8.7% in 2020 (13.0% if shareholdings by insurance companies are included).<sup>17</sup> Not only do cross shareholdings insulate a company from unsolicited takeover bids and activist campaigns, studies indicate that a high level of cross-shareholding is associated with lower M&A expenditure.<sup>18</sup>

These corporate governance reforms have also encouraged increasing levels of shareholder activ-

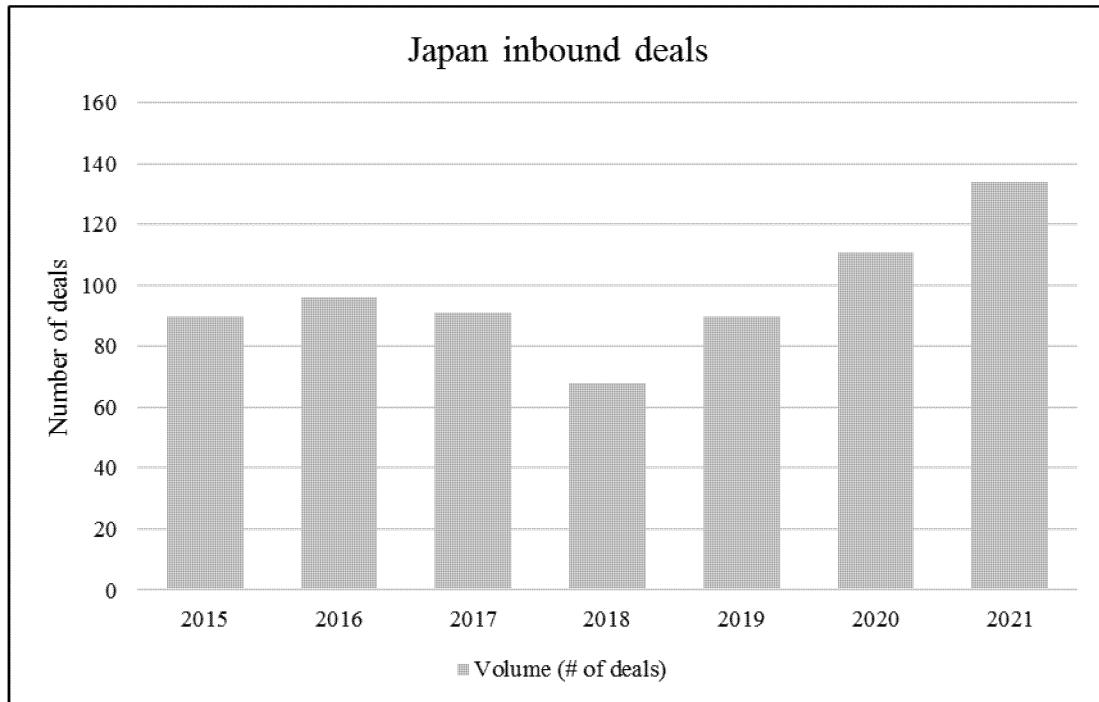
ism in recent years. For example, the number of activist investors in the Japanese market has increased from seven in 2014 to 44 in 2020,<sup>19</sup> and the shareholder meeting season in 2022 (which in Japan is in June) reportedly saw a record number of activist proposals.<sup>20</sup>

### **Impacts of Corporate Governance Reforms on Japanese M&A Activity**

The above corporate governance reforms appear to have provided tailwinds for M&A activity in Japan, which has increased not only in sheer volume but also in the nature and variety of transactions. According to Recof, a Japanese M&A advisory firm, the number of M&A transactions involving Japan increased steadily from 2012 to 2019, and after a fall in 2020 due to the impacts of the COVID-19 pandemic, the number and value of M&A transactions hit a record high in 2021.<sup>21</sup>

In particular, the number of inbound M&A deals into Japan has shown a general increasing trend in recent years, exceeding levels prior to the COVID-19 pandemic (see Figure 1). The value of inbound M&A deals into Japan shows a similar trend in recent years,<sup>22</sup> but is heavily skewed by a few exceptionally large deals.

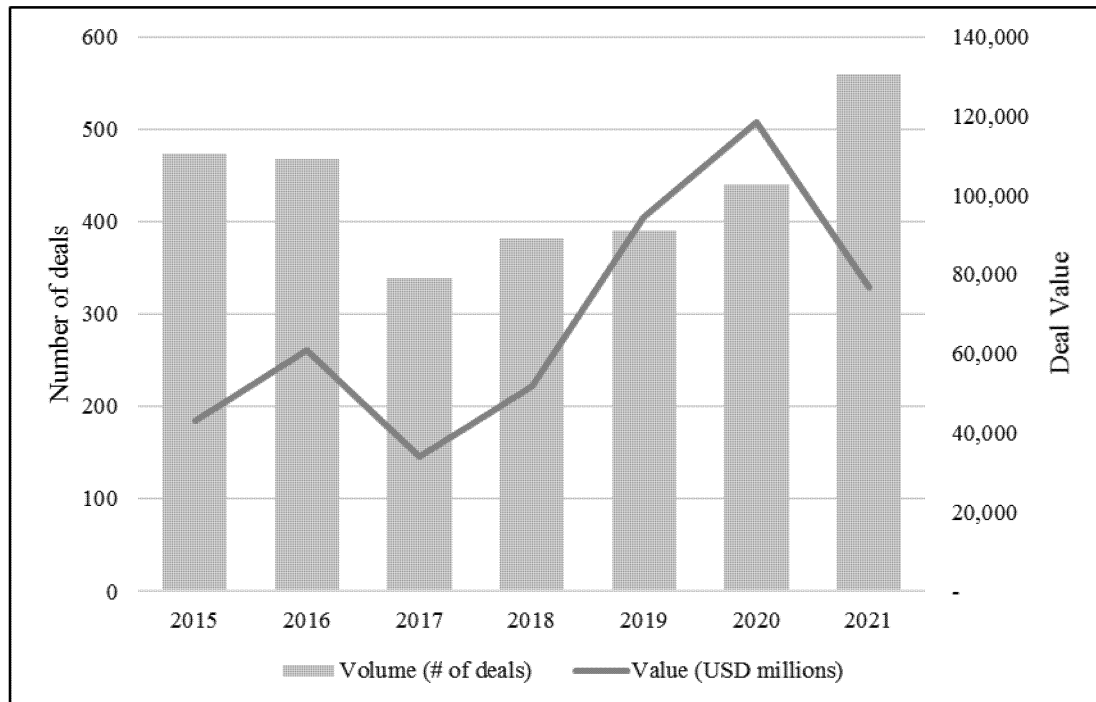
*Figure 1: Japan Inbound M&A Deals (by Number of Deals) (Source: Refinitiv)*



Furthermore, M&A activity involving a Japanese public company target has also shown a general increasing trend since 2015 both by deal value and number of deals (see Figure 2). These transactions have included a notable uptick in unsolicited and contested takeover bids by major Japanese compa-

nies, such as furniture retailer Nitori Holdings' 2020 successful \$2 billion topping bid for do-it-yourself and hardware retailer Shimachu, and Hoya Corporation's unsuccessful counterbid for NuFlare Technology, Inc.

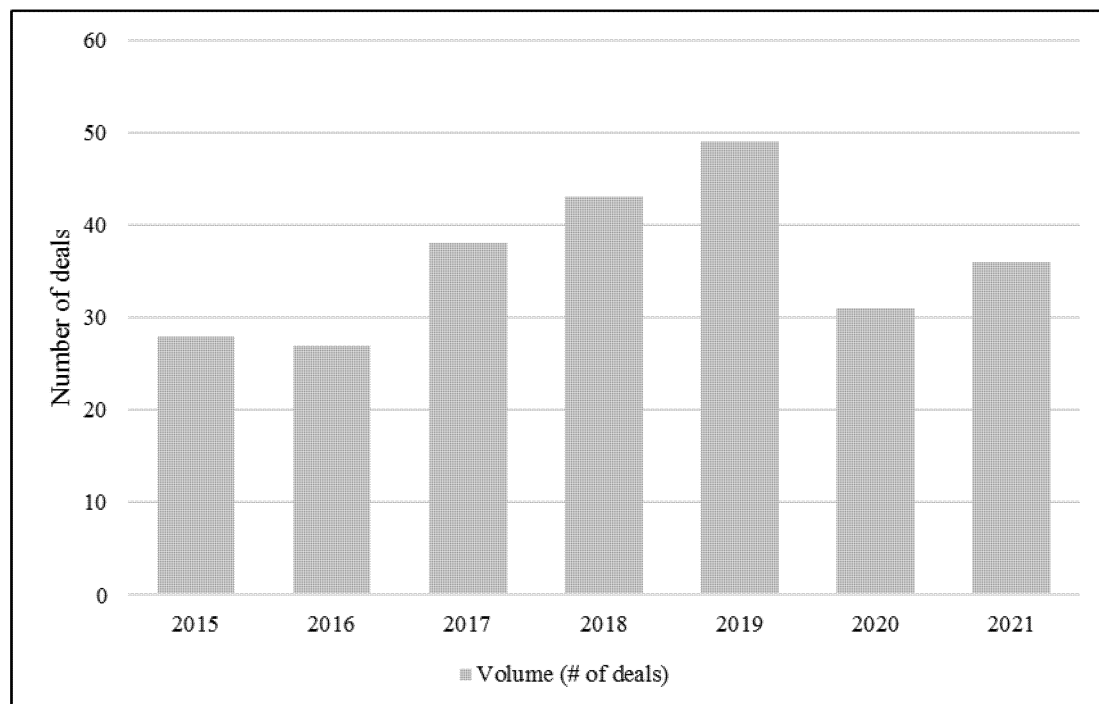
**Figure 2:** M&A Deals Involving a Japanese Public Company Target (By Number of Deals and By Value) (Source: Refinitiv)



Finally, Japan has seen a continuing trend of companies selling non-core assets, with a general increasing trend in the number of divestitures, although numbers post-pandemic have not yet recovered to their pre-pandemic highs (see Figure 3). This trend of non-core asset sales and general increase in M&A activity has coincided with an unprecedented number of private equity funds entering the Japan market, which had historically been perceived as unattractive for private equity.<sup>23</sup> The size of the

private equity market in Japan has been an outlier among developed nations, accounting for only 0.2% of GDP during the period from 2014 through 2018, compared to 3.2% for the United States and 2.4% for Europe during the same period.<sup>24</sup> Notable recent deals include KKR's take private of Hitachi Transport, Hitachi's sale of Hitachi Metals to a consortium led by Bain Capital and Shiseido's sale of its personal care business to CVC.

*Figure 3: M&A Deals Involving a Divestiture by a Japanese Company (By Number of Deals)*  
(Source: Refinitiv)



### Impediments to the Future Development of the Japanese M&A Market

Despite the significant corporate governance improvements Japan has made in recent years, various hurdles remain in the continued development of a robust and effective market for corporate control in Japan.

#### *The Market for Executive Employment in Japan*

Several of the most significant impediments to increased M&A activity in Japan relate to the Japanese executive employment market. Despite a very gradual shift away from Japan's historical system of lifetime employment, there continues to be only a limited market for lateral employee hiring by Japanese companies, particularly at the executive level.

For instance, in 2018, 97% of Japanese CEOs were promoted from within, with only 3% hired externally, compared with 21% in the United States and Canada.<sup>25</sup> As a result, executives at a Japanese company who may lose their positions due to an acquisition are unlikely to be able to find comparable positions at Japanese companies of similar stature in the same industry.

The impact on Japanese M&A of the lack of alternative employment opportunities for senior executives is compounded by two other characteristics of executive employment in Japan. First, annual compensation of Japanese executives is just a fraction of that in the U.S. and Europe. In 2019, the total compensation of CEOs of Japanese large companies was less than a third of similarly sized UK and German companies and less than a seventh of that of



similarly sized U.S. companies.<sup>26</sup> Second, contractual “golden parachutes” for executives who are terminated following a change of control are virtually unheard of at Japanese companies. As a result, not only are Japanese executives unable to find comparable positions if they lose their job following the sale of their company, they are also unlikely to be protected from this risk by either being financially independent or being compensated in the event of a change of control through a golden parachute. This self-interest naturally leads Japanese executives to oppose any sale of their companies, even if it is a compelling transaction from the perspective of their shareholders. Although it is hard to imagine Japanese companies adopting CEO pay and golden parachutes to the extent that U.S. companies have, given the differences in the cultural and political environment, a small measure of these might provide significant stimulus to M&A activity in Japan.

### *Unresolved Corporate Governance Challenges*

Despite the significant corporate governance reforms during the past decade, additional corporate governance reforms may further stimulate M&A activity and ensure investors that the market for corporate control operates efficiently and fairly. For example, notwithstanding the increasing presence of independent directors on the boards of Japanese listed companies, they remain a minority at a substantial majority of public companies, with only 15% of listed companies reviewed by ISS having a majority of independent directors.<sup>27</sup> Thus, at most Japanese companies, inside directors (with the structural bias against sell-side M&A activity described above) control decision making in respect of any sale of the company or significant divestitures.

In addition, one aspect of a well-functioning M&A market is a governance and regulatory system

that ensures a fair price for shareholders where the management/insider directors are conflicted (such as a transaction with a controlling shareholder or a management buyout). The Fair M&A Guidelines, issued in 2019 by Japan’s Ministry of Economy, Trade and Industry in order to address such M&A transactions with structural conflicts, set forth certain non-binding principles and “best practices” to guide companies and their advisors. These included recommendations for establishing special committees, retaining outside experts, obtaining financial analyses and/or fairness opinions, conducting market checks, and using majority-of-minority conditions. Despite this step in the right direction, there have been a series of transactions in Japan over the past few years that demonstrate that this is an area requiring further improvement.

In contrast to *Revlon* duties under Delaware law which require a board of directors, once it has determined to sell control of the company, to achieve the best price reasonably available for its shareholders, fiduciary duties under Japanese corporate law emphasize the board of directors’ obligation to maximize the long-term “corporate value” of a company even in a sale of the company for cash. The Fair M&A Guidelines note that there can be an “exceptional case” where a bidder’s contribution to “corporate value” is not aligned with the benefits to the public shareholders, which could result in a target rejecting an objectively higher cash bid to pursue a lower bid that the target’s directors subjectively believe will contribute more to future “corporate value.”<sup>28</sup>

One such situation occurred soon after the release of the Fair M&A Guidelines in a competitive bidding situation for Unizo Holdings, a Tokyo-based property company. In setting forth its policy for evaluating bids, Unizo specifically referred to the Fair M&A Guidelines to indicate that it viewed both corporate value and shareholder value as important

and, in the case of conflict, would seek to harmonize them,<sup>29</sup> and reportedly rebuffed bids from certain private equity firms that failed to meet Unizo's conditions regarding employee participation in the future management of the company.<sup>30</sup> Compared to the United States (notwithstanding the recently re-invigorated debate in the United States over shareholder versus stakeholder capitalism), the Fair M&A Guidelines provide Japanese boards with significant latitude in favoring its preferred bidder over a bidder that objectively provides the highest value to the public shareholders.

#### *Lack of Strong Enforcement Mechanisms for Shareholder Rights*

Finally, Japan lacks a strong enforcement mechanism to hold boards of directors or corporate officers to account in the event they do not act in the best interest of shareholders in connection with the sale of the company. Although certain activist shareholders have initiated legal action in Japanese courts (sometimes with success) to challenge board decisions in respect of conflicted M&A transactions, such shareholders must bring any lawsuit on an individual basis and thus bear the entire financial cost of such lawsuits. The Japanese system for class actions is quite limited, requiring certain qualified consumer organizations to bring the action,<sup>31</sup> and because remedies in such actions are limited to injunctive relief, the system has not been widely used by investors.<sup>32</sup>

In contrast, the U.S. system allowing class action lawsuits for claims of breach of fiduciary duties and securities law violations, coupled with an independent and aggressive plaintiffs' bar, provides a framework for policing conflicted behavior even where it may not be economically efficient for individual shareholders to bring a claim. For instance, in 2018, 82% of public M&A deals over \$100 million were subject to a shareholder lawsuit.<sup>33</sup> Class action

M&A litigation in the U.S. has been the subject of much justified criticism,<sup>34</sup> with a rise in M&A litigation leading the Delaware Court of Chancery to limit so-called "disclosure only" settlements.<sup>35</sup> Nonetheless, it is hard to deny that it has played a significant role in shaping the behavior of corporate boards in conflicted M&A transactions, likely resulting in more positive outcomes for public shareholders.<sup>36</sup>

#### **Conclusion**

Despite the increasing volume, depth, and complexity of Japanese M&A activity in recent years, driven by extensive corporate governance reforms and underlying economic trends, there remains a strong need for continued improvements given the long-term challenges facing the Japanese economy. A more robust market for corporate control in Japan, propelled by changes in the executive employment market, continued progress on corporate governance reforms and more vigorous enforcement of shareholder rights, would help ensure that the assets of Japanese businesses are put to their most productive use, unlocking value for the Japanese economy as a whole.

#### **ENDNOTES:**

<sup>1</sup>See, e.g., Columbia Business School, "Why M&A Is Different in Japan," (January 5, 2015).

<sup>2</sup>Refinitiv and World Bank data.

<sup>3</sup>Japan External Trade Organization, "JETRO Invest Japan Report 2021," (November 2021).

<sup>4</sup>Richard Katz, American Chamber of Commerce in Japan, "Japan as 196th," (November 17, 2021).

<sup>5</sup>Statistics Bureau of Japan, "Basic Complete Tabulation on Population and Households of the 2020 Population Census of Japan," (December 28, 2021).

<sup>6</sup>Statistics Bureau of Japan, "Current Population Estimates as of October 1, 2021," (October 1, 2021).

<sup>7</sup>National Institute of Population and Social Se-



curity Research, “Population Projections for Japan (2016-2065),” (April 2017).

<sup>8</sup>Cabinet of Japan, “Japan Revitalization Strategy: Japan is Back,” (June 14, 2013).

<sup>9</sup>*See, e.g.*, Milhaupt, Curtis J., “Evaluating Abe’s Third Arrow: How Significant are Japan’s Recent Corporate Governance Reforms?” (October 31, 2017).

<sup>10</sup>Ministry of Economy, Trade and Industry, “Fair M&A Guidelines: Enhancing Corporate Value and Securing Shareholders’ Interests” (June 28, 2019).

<sup>11</sup>*See, e.g.*, Miyajima, Hideaki and Saito, Takuji, “Corporate Governance Reforms under the Abenomics: the Economic Consequences of Two Codes” (October 19, 2019).

<sup>12</sup>*See, e.g.*, Takeo Hoshi, “Kishida’s New Form of Capitalism,” (March 22, 2022).

<sup>13</sup>Tokyo Stock Exchange, Inc., “TSE-Listed Companies: White Paper on Corporate Governance 2021” (March 2021).

<sup>14</sup>ISS Insights, “Japanese Companies Register Progress on Board Independence and Diversity” (April 21, 2022).

<sup>15</sup>Tokyo Stock Exchange, Inc.

<sup>16</sup>*Id.*

<sup>17</sup>Nomura Institute of Capital Markets Research, “The Status of Cross-Shareholdings by Listed Companies in Japan” (translated from Japanese) (2020).

<sup>18</sup>Miyajima and Saito.

<sup>19</sup>IR Japan, “Financial Results for the Fiscal Year Ended March 31, 2021,” (May 10, 2021).

<sup>20</sup>*See, e.g.*, Yahoo! Japan, “Activist Proposals Double to 36 Companies, Record High” (translated from Japanese) (June 11, 2022).

<sup>21</sup>Recof Japan, “Information of cross-border M&A market,” January 14, 2022.

<sup>22</sup>Refinitiv data.

<sup>23</sup>*See, e.g.*, Nikkei Asia, “Japan entices global funds hungry for pandemic spinoffs” (February 18, 2021).

<sup>24</sup>Kazuaki Washim, Bank of Japan Reports & Research Papers, “Prospects of Private Equity Funds in Japan: Expectations toward Finance with Ideas and Commitment,” (December 2020).

<sup>25</sup>Strategy&, “2018 CEO Succession Survey,” (translated from Japanese) (June 2019).

<sup>26</sup>Willis Towers Watson, “CEO pay landscape in Japan, the U.S. and Europe: 2020 analysis,” (December 9, 2020).

<sup>27</sup>ISS Insights.

<sup>28</sup>Ministry of Economy, Trade and Industry.

<sup>29</sup>UNIZO Holdings Company, Limited, “Concerning Our Basic Policy for Dealing with Proposals to Acquire Our Company,” (translated from Japanese) (September 27, 2019).

<sup>30</sup>*See, e.g.*, Financial Times, “Unizo battle puts Japan governance in spotlight,” (October 3, 2019); Reuters, “What makes Japanese hotelier Unizo attractive for Blackstone and Elliott?” (October 17, 2019).

<sup>31</sup>Oki Mori, Aki Watanabe and Natsumi Kobayashi, “The Class Actions Law Review: Japan” (April 21, 2022).

<sup>32</sup>Masakazu Iwakura et al., “The Securities Litigation Review: Japan” (May 22, 2022).

<sup>33</sup>Cornerstone Research, “Shareholder Litigation Involving Acquisitions of Public Companies: Review of 2018 M&A Litigation,” (July 1, 2019).

<sup>34</sup>*See, e.g.*, Michelle Reed and Matthew Lloyd, “Stemming the tide of meritless securities class actions,” (March 8, 2019).

<sup>35</sup>*See, e.g.*, Peirluigi Matera and Ferruccio M. Sbarbaro, “From *Trulia* to *Akorn*: A Ride on the Roller Coaster of M&A Litigation,” (2020).

<sup>36</sup>*See, e.g.*, C.N.V. Krishnan et al., “Shareholder litigation in mergers and acquisitions” (December 2012) (finding that M&A offers subject to shareholder class action lawsuits were associated with significantly higher takeover premia offsetting a decline in the probability of deal completion).