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More documents related to this discussion can be found at www.oecd.org/daf/competition/safe-harbours-and-legal-presumptions-in-competition-law.htm

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1. Introduction

1. Japan Fair Trade Commission (hereinafter referred to as “JFTC”) has strictly enforced the Antimonopoly Act (hereinafter referred to as the “AMA”) to anticompetitive conduct in order to encourage fair and free competition. However, the AMA does not provide for clear and precise provisions on anticompetitive conduct. Thus, JFTC has formulated various guidelines for helping in understanding anticompetitive conduct and for securing transparency in application of the AMA.
2. Some guidelines provide for safe harbour rules that describe conduct that is deemed not to violate the AMA. JFTC sets out safe harbours in the “Guidelines Concerning Distribution Systems and Business Practices under the Antimonopoly Act (hereinafter referred to as the “DSBPG”)” and the “Guidelines to Application of the Antimonopoly Act concerning Review of Business Combination (hereinafter referred to as the “MRG”; Merger Review Guidelines).”
3. The main purpose of this contribution paper is to introduce the overview of the safe harbours in the two guidelines and to explain the reasons behind the adoption of the safe harbours.

2. Safe harbours set out in the DSBPG

2.1. Overview of the DSBPG

4. The DSBPG is intended to contribute to preventing companies and trade associations from violating the AMA and helping in the pursuit of their appropriate activities, by specifically describing, with respect to Japanese distribution systems and business practices, what types of conduct in commercial transactions may impede fair and free competition and therefore violate the AMA. Part I of the DSBPG provides guidance on JFTC’s principles for the assessment of restrictions on trading partners’ business activities, e.g. resale price maintenance, restrictions on dealings with competitors, restrictions on sales territories, restrictions on retailers’ sales methods, under Article 19 of the AMA (“unfair trade practices”).

2.2. Criteria for judging illegality of vertical restraints

5. Any vertical restraints which tend to impede fair competition are prohibited under the AMA as unfair trade practices. The assessment of whether a particular vertical restraint “tends to impede fair competition” or not is made by considering the scope of the market influenced by the restraint depending on factors such as objects, regions and manners of the restraint and relevant transaction, and then comprehensively assessing relevant factors including conditions of inter-brand competition and intra-brand competition. In this assessment, due consideration is given to not only anti-competitive effects, but also pro-competitive effects.

6. In line with this approach, the DSBPG provides for more detailed assessment criteria with respect to each type of vertical restraints as follows:

- i. The respective types of non-price vertical restraints categorised as “restrictions on dealings with competitors, etc.”¹, “strict territorial restrictions”² and “tie-in sales” are illegal when:
 - such restraints are imposed by “an influential company in the relevant market”, and
 - such restraints have “foreclosure effects”³ or “price maintenance effects”⁴ and therefore tend to impede fair competition.
- ii. The respective types of vertical non-price restraints categorised as “restrictions on passive sales to outside customers”⁵, “requirement of designated accounts”⁶ and “Prohibition of sales among distributors”⁷ are illegal, even if imposed by companies other than “an influential company in the relevant market, when such restraints have “price maintenance effects” and therefore tend to impede fair competition.
- iii. Vertical price restraints, i.e. “resale price maintenance”, and vertical non-price restraints categorised as “prohibition of sales to price-cutting retailers” and “restrictions on advertisements, representations, etc. of prices” tend to impede fair competition in principle and are therefore illegal.

2.3. Overview of safe harbours set out in the DSBPG

7. The DSBPG stipulates whether or not “an influential company in the relevant market” (2.2.i above) is in the first instance judged by a market share of the company, that is, whether or not it has a share exceeding 20% in the relevant market. Thus, in cases

¹ “Restrictions on dealings with competitors, etc.” refer to the case where a company engages in transactions with its trading partners on anti-competitive conditions, for example, the trading partners cannot deal with competitors of the company.

² “Strict territorial restrictions” refer to the case where a company assigns a specific area to each distributor and restricts the distributor’s sale of the company’s products outside the assigned area.

³ “Foreclosure effects” mean anti-competitive effects caused by those restraints that can exclude new entrants and existing competitors and decrease opportunities available to them. Those restraints make it difficult for new entrants and existing competitors to acquire alternative trading partners, and cause increase of their expenses for business activities and/or their discouragement from entering the market or developing new products.

⁴ “Price maintenance effects” mean anti-competitive effects caused by those restraints that lessen competition among the restrained company and its competitors and enable it to control its sales prices at its own discretion and thus maintain or raise the prices.

⁵ “Restriction on passive sales to outside customers” refers to the case where a company assigns a specific area to each distributor and restricts the distributor’s sale of the company’s products to customers outside the assigned area upon such customers’ request.

⁶ “Requirement of designated accounts” refers to the case where a company requires each wholesaler to trade only with the specified retailers, so that each of the retailers can buy the company’s products only from the designated wholesaler.

⁷ “Prohibition of sales among distributors” refers to the case where a company prohibits distributors from buying and selling the company’s products between distributors.

a company which has a market share of 20% or less or a new entrant commits any conduct described in 2.2.i above, it does not usually tend to impede fair competition and therefore is presumably not illegal. This is the so-called safe harbour. Nevertheless, even if a vertical restriction falls outside of the safe harbour, it does not necessarily mean that it is illegal under the AMA; such restriction is illegal only when it has “foreclosure effects” or “price maintenance effects”.

8. In other words, this safe harbour has been introduced in line with the purpose of the DSBPG, which is to contribute to the prevention of companies and trade associations from violating the AMA and making their business activities appropriate. It is designed to secure predictability for companies and trade associations and to avoid causing a chilling effect on business activities by the enforcement of the AMA, and not to reduce JFTC’s burden of conducting in-depth analysis and proving the illegality of conduct.

9. Meanwhile, in the light of those reasons behind the adaption of the DSBPG, JFTC does not positively argue that an individual restraint by a company falls within the scope of the safe harbour. Also, even if a company asserts that its business activity falls within the scope of the safe harbour, JFTC may rebut by arguing that it falls outside the scope of the safe harbour or that it falls within the scope of the safe harbour but it exceptionally impedes fair competition.

2.4. Criteria of “an influential company in the relevant market⁸” and reasons behind

2.4.1. Market share criteria

10. When the DSBPG was established in 1991, it prescribed the safe harbour criterion that “the company has a market share of less than 10% and its position is not within the top three in the relevant market”. However, over the last couple of years, it had been claimed that the scope of application of this safe harbour rule was too narrow for companies and that it was not fully serving the purpose of securing predictability. Accordingly, JFTC reviewed the safe harbour rule and other relevant matters in light of such circumstances. As a result, upon the 2016 revision of the DSBPG, the current criterion of “a market share of 20% or less” was adopted, and the criterion of not having the position within the top three in the relevant market was abolished.

11. The reason of this revision is based on JFTC’s enforcement experience: there are some JFTC’s decisions and courts’ judgements where vertical non-price restraints by companies with market share of less than 30% were found to be in violation of the AMA as the restraints had price maintenance effects. Additionally, JFTC also took into account that the “Guidelines for the Use of Intellectual Property under the Antimonopoly Act”, which also indicate JFTC’s assessment approaches from the viewpoint of applying

⁸ The DSBPG defines “the relevant market” as follows: a product market which consists of a group of products with the same or similar functions and utility as the product covered by the relevant restriction, and competing with each other judging from geographical conditions, transactional relations and other factors. It is determined, in principle, in terms of substitutability for users, and when necessary, also of substitutability for suppliers.

Article 19 of the AMA (“unfair trade practices”), set a 20% market share as a safe harbour criterion (cases where the anti-competitive effect is minor).⁹

12. In addition, the criterion of the position in the market, which had consistently excluded the top three companies in each market from application of the safe harbour, was abolished at the same time as raising the market share criterion from “less than 10%” to “20% or less”. This was because the market structure differed by industry, and the market share percentage of each of the top three companies also varied.

2.4.2. Types of conduct subject to application of safe harbours and types that are not

13. The DSBPG states, as described in 2.2.i above, that the respective types of non-price vertical restraints categorised as “restrictions on dealings with competitors, etc.”, “strict territorial restrictions” and “tie-in sales” are subject to application of the safe harbour.

14. Meanwhile, any vertical non-price restraints categorised as “prohibition of sales to price-cutting retailers” and “restrictions on advertisements, representations, etc. of prices” (listed in 2.2.iii above) are not subject to application of the safe harbour, as well as resale price maintenance, since they are illegal in principle. Also, as described in 2.2.ii above, any vertical non-price restraints which raise competition concerns if they have price maintenance effects, i.e. “restrictions on passive sales to outside customers”, “requirement of designated accounts” and “prohibition of sales among distributors”, are not subject to application of the safe harbour either. The reason why the safe harbour does not apply to those conduct is as follows:

15. “Restrictions on passive sales to outside customers” have a greater effect to restrict intra-brand competition than “strict territorial restrictions”, which only prohibits active sales to customers outside an assigned area, since the former also restricts sales in response to requests from customers outside the assigned area. More specifically, “restrictions on passive sales to outside customers” make it impossible for customers to buy products/services from any distributors outside of the area, so that distributors are likely to become influential in the market and to maintain price.

16. Also, “requirement of designated accounts” means that a company assigns particular retailers to each wholesaler. It prohibits wholesalers from accepting any offer by other retailers than the assigned retailers. This restraint has similar anti-competitive impact as “restrictions on passive sales to outside customers”, thus JFTC adopts the same approach to both of them.

17. Moreover, since “prohibition of sales among distributors” imposes restrictions on selection of trading partners, which is an essential element of transactions, it may lead to restrictions on competition in the distribution market, depending upon a manner of the restrictions.¹⁰

⁹ The safe harbour criterion under the “Guidelines for the Use of Intellectual Property under the Antimonopoly Act” was set by referring to the criteria in other domestic and foreign guidelines, from various viewpoints including international consistency.

¹⁰ In cases where “prohibition of sales among distributors” is aimed at the prohibition of selling to price-cutting retailers, such prohibition tends to impede fair competition, and therefore, in principle, is illegal.

18. To sum up, among other types of vertical non-price restraints (and although they are “non-price” restraints), “restrictions on passive sales to outside customers”, “requirement of designated accounts” and “prohibition of sales among distributors” have greater negative effects on price competition. For that reason, JFTC considers it is not appropriate to apply the safe harbour to these categories of vertical restraints.

3. Safe harbours set out in the MRG

3.1. Overview of the MRG

19. The AMA prohibits share acquisition, merger, joint incorporation-type split, absorption-type split, joint share transfer, or acquisition of business (hereinafter collectively referred to as “merger”), which would substantially restrain competition in any relevant market. These plans for mergers are subject to a prior notification system based on the AMA. JFTC reviews whether or not plans for merger would substantially restrain competition in any relevant market (hereinafter referred to as “merger review”) in light of procedures provided in the AMA.

20. With the aim of securing transparency and predictability of merger reviews, JFTC provides the MRG.

21. The structure of the current MRG is as follows:

- i. the categories of mergers that are to be reviewed under the AMA
- ii. the criteria for defining a relevant market
- iii. the meaning of “would substantially restrain competition”
- iv. determining factors in deciding substantial restraint of competition through horizontal merger
- v. determining factors in deciding substantial restraint of competition through vertical and conglomerate merger
- vi. remedies

3.2. Overview of the safe harbours set out in the MRG

22. With the view of securing transparency and predictability of merger reviews, JFTC provides the scope of merger which would not substantially restrains competition in the MRG; this is the safe harbour.

23. Even a merger which meets the safe harbour criteria could pose a problem under the AMA. However, JFTC normally clears any merger falling within the safe harbour unless there are special circumstances, because it can cause a change in the market structure only to a small extent and have a minor effect on competition.

24. At the same time, even if a merger does not meet the safe harbour criteria, that fact alone does not make the merger problematic under the AMA. If a merger does not meet the safe harbour criteria, JFTC reviews the merger based on the factors indicated in the MRG.

25. As mentioned in 3.4 below, JFTC has formulated the safe harbour based on the accumulation of experience in past merger reviews, and not from the viewpoint of reducing JFTC’s examination burden in judging the illegality of mergers.

3.3. Criteria of the HHI and market share

3.3.1. *Criteria applicable to horizontal mergers*

26. When a horizontal merger falls under either of the following standards below, it is normally considered that the effect of the merger would not substantially restrain competition in the relevant market.

- The Herfindahl-Hirschman Index (hereinafter referred to as the “HHI”) after the merger is not more than 1,500.
- The HHI after the merger is more than 1,500 but not more than 2,500 while the increment of the HHI is not more than 250.
- The HHI after the merger is more than 2,500 while the increment of the HHI is not more than 150.

3.3.2. *Criteria applicable to vertical and conglomerate mergers*

27. When a vertical and conglomerate merger falls under either of the following standards below, it is normally considered that the effect of the merger would not substantially restrain competition in the relevant market.

- The market share of the merging companies after the merger is not more than 10% in all of the relevant markets.
- The HHI is not more than 2,500 and the market share of the merging companies after the merger is not more than 25% in all of the relevant markets.

3.4. Reasons behind the safe harbour in the MRG

3.4.1. *Grounds for the HHI standards*

28. The current safe harbour criteria in the MRG were adopted in 2007. JFTC sets out the current safe harbour criteria based on its experience in past merger reviews; it extracted past cases which were cleared without any condition, cases which went to a detailed review and cases in which JFTC pointed out competition concerns, checked the HHI and the HHI increment in each of these cases, and then determined the appropriate levels of the HHI and the HHI increment for the safe harbour.

3.4.2. *Reason for the merger-type-based criteria of the safe harbour*

29. The HHI is the sum of the squared market share of each company in the relevant market; it indicates the degree of oligopoly in a market. In a merger review, JFTC focuses on how significant the merger has altered the market structure, so by looking at not only the HHI, but also the HHI increment, it can identify the alteration of the market structure after the merger.

30. The MRG adopts different safe harbour criteria depending on the type of mergers: it uses the HHI and the HHI increment for horizontal mergers, and uses both the market share and the HHI for vertical and conglomerate mergers. This is because, horizontal mergers and vertical and conglomerate mergers differ in terms of the degree of increase in the HHI and of the impact on competition. In the case of horizontal mergers among companies in the same market, the market shares of the companies will be combined and

then the HHI will increase, while in the case of vertical and conglomerate mergers among companies in different markets, the HHI does not increase.

4. Conclusion

31. As explained above, JFTC sets out the safe harbours in the DSBPG and MRG.

32. In developing the safe harbour criteria in both of these guidelines, JFTC has taken into consideration its past enforcement and precedents, as well as the anti-competitive effects of the respective types of conduct, and if necessary, the international consistency. Meanwhile, the guidelines have been formulated with the primary focus to secure the predictability for companies, and they have not been developed from the viewpoint of JFTC's capacity.