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Merger Control Under the Anti-Monopoly Act of Japan

With Asia's most developed economy, Japan is home to a vibrant M&A market where multi billion-dollar deals are a regular occurrence. As in other developed countries, M&As in Japan are subject to regulations designed to protect fair competition in the market. What are the M&A review processes under Japan's Anti-Monopoly Act and how are they being updated to ensure that deals are impeded as little as possible? By Yusuke Nakano and Yoshinori Aoyagi of Anderson Mori & Tomotsune in Tokyo, Japan.

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Chapter four of the *Anti-Monopoly Act of Japan* (AMA) addresses merger control by the competent authority in Japan - the Japan Fair Trade Commission (JFTC).[1] As the wording of one provision of the AMA states "where the effect may be substantially to restrain competition in any particular field of trade," with regard to merger control, the AMA focuses on the relative scale of the company(ies) in certain market(s).

As M&As are conducted with a view to expansion of the scale of a company (from the viewpoint of at least one party), in many M&As the merger control provisions in the AMA have to be consulted. In respect of the types of M&As that may be subject to merger control under the AMA, reporting by the JFTC shows that the number of share acquisition M&As is the largest. As such, in this article we would like to discuss merger control by focusing on the control of share acquisitions.

Framework of merger control

Merger control provisions under the AMA consist of the following: share acquisition (Sections 10 and 14); interlocking directorates (Section 13); merger (Section 15); corporate demerger (Section 15-2) and business transfer, etc. (Section 16). Because the AMA has a provision regarding interlocking directorates, the term "business combination" is used by the JFTC rather than the term "M&A". We will basically use the terms "M&A" and "merger control" in this article. We can classify them into "pre-M&A regulation" and "post-M&A regulation" in terms of timing and purpose of regulation as detailed below.

i) Pre-M&A regulation

Here, pre-M&A regulation means the requirements to notify or report to the JFTC for the purpose of enabling the JFTC to screen out M&As which are problematic under the AMA.

More specifically, for example, in certain shareholdings, "*ex post facto*" reporting is required. Roughly, a company (including foreign company) whose total assets exceed ¥2 billion (US$19.1 million) - and exceed ¥10 billion when the total assets of the parent company and its subsidiaries are combined (restricted to companies in Japan) - may be subject to such

Inside asialaw JAPANReview

Merger Control Under the Anti-Monopoly Act of Japan 1

Offshore Funds - Structures Using Privately-Placed Foreign Investment Trusts 7

The Class Action Fairness Act of 2005: New Protections for Corporate Dependants and Consumers 12

Updates

Proposed Deregulation of Consideration for Mergers Under the New Corporation Act of Japan 17

Investment Vehicles – Update of Key Developments 18

Current Issues in Outbound Investment from Japan 19

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reporting requirement, if it acquires shares in another company whose total assets (domestic turnover during the last fiscal year in case of a foreign company) are over ¥1 billion and if it newly exceeds either of the following shareholding ratio thresholds as a result of acquisition of shares: 10%, 25% or 50%.

If the reporting requirement is triggered, such a company shall file an *ex post facto* report within 30 days of such an acquisition. As only *ex post facto* reporting is required for share acquisitions, there should be no waiting period or clearance issues.[2]

On the other hand, in regard to a merger, corporate demerger, or business transfer, prior notification may be required. Generally, if the total assets of one of the parties to a merger exceeds ¥10 billion and the assets of another party exceed ¥1 billion, notification will be required. Where foreign corporations merge, instead of total assets, turnover in Japan for the previous fiscal year is the threshold employed. If prior notification is filed, the parties cannot complete the transaction until the waiting period (which is basically 30 days, but may be shortened or extended until the later of the 120th day from the notification, or the 90th day after responding to requests for additional information) has expired, without the JFTC's taking necessary measures.

The aforementioned constitute a rough summary of the pre-M&A regulation aspects of merger control under the AMA. The most unique feature of the pre-M&A regulation system in contradistinction to the US and EU systems is that only *ex post facto* reporting is required as to share acquisition. Furthermore, no filing fee is required.

ii) Post-M&A regulation

In addition to the pre-M&A regulation, the AMA states that business combinations are prohibited "where the effect may be substantially to restrain competition in any particular field of trade." If such a violation exists, the JFTC is authorized to take the necessary measures to rectify such a violation, including ordering the disposition of shares and/or businesses. The JFTC has actually exercised its authority and ordered the disposition of shares.

Informal prior consultation

Since the shareholding report is submitted *ex post facto*, a certain legal risk exists that the JFTC will order the disposition of shares after acquisition, where the JFTC concludes that the effect of such an acquisition "may be substantially to restrain competition." In the case of other types of M&As like mergers, it would be very inconvenient for the parties to be required to file notification with the JFTC only after conducting substantial due diligence and hard negotiations if it is possible that the JFTC will determine that the proposed M&A "may be substantially to restrain competition." In such a case, the costs, resources and time spent by the parties on the proposed M&A may be completely lost.

For these reasons, it has become an established practice in Japan that parties to an M&A informally consult with the JFTC well before the scheduled closing date. The decisions reached by the JFTC in the prior consultation are considered final, even though such a "prior consultation system" has no clear basis under Japanese legislation. Naturally, the parties are not required to engage in any prior consultations. However, because the findings of the JFTC determined in prior consultation proceedings will not be overturned in the absence of extreme circumstances, many parties make prior consultation a priority except where legal advisors can issue a very confident opinion.

Correspondingly, the business community and the Ministry of Economics, Trade and Industry (METI) have complained that the standard employed by the JFTC in prior consultations is unclear even though the process plays a very important role in the review of M&As and that predictability of the results of JFTC's review is low. While the former *Guidelines for Interpretation on the Stipulation that the Effect May Be Substantially to Restrain Competition in a Particular Field of Trade Concerning M&As* ('Old Guidelines') were in force, they were criticized for failing to secure sufficient predictability. Further, there was a great amount of displeasure with the transparency of the review procedures, especially its duration which was nowhere stated. Moreover, due to the dearth of information publicly disclosed regarding cases reviewed by the JFTC, judgements of the JFTC could not be reliably predicted.

The JFTC has made efforts to respond to these criticisms. First, in 1993 the JFTC announced that it would disclose in detail the cases which it reviewed under the prior consultation system. Especially, since 1996, the disclosure of cases subjected to the prior consultation process (including cases where the parties abandoned their M&A plan) has been increasing. Moreover, as an initiative to make the prior consultation procedures quicker and more transparent, the *Policy Regarding Accepting Prior Consultation on M&A Plans* was implemented on December 11 2002.

In addition, in order to quickly review M&As in the interests of industrial revitalization, a *Review of Mergers and Acquisitions Regarding Revitalization of Companies and Industries* was introduced on April 9 2003. On May 31 2004, the *Guidelines to Application of the Anti-Monopoly Act Concerning Review of Business Combination* ('New Guidelines') were introduced to generally solidify the elements of transparency and predictability in the review of M&As.

Flow of review under the New Guidelines

The following briefly outlines the flow of review under the New Guidelines, with particular emphasis on what is considered their distinguishing feature - safe harbour and remedy.

i) Determination of whether the proposed M&A is subject to the review

In regard to shareholding, in principle, an M&A is subject to review if: (i) the post-acquisition shareholding ratio is over 50%; or (ii) the post-acquisition shareholding ratio is over 25% and the relevant party is the largest shareholder. In addition, if the shareholding ratio is over 10% and the relevant party is one of the three largest shareholders, depending on the status of the distribution of shares and the ranking of the shareholder, the proposed transaction may be subject to review.

ii) Definition of a particular field of trade (market definition)

First of all, there may be many "particular fields of trade" in a single merger or acquisition. In the 2002 merger of Mitsui Chemicals and Sumitomo Chemical, the JFTC found 61 markets in which the parties were competing. Of the 61 markets, the JFTC scrutinized nine markets in depth.

According to the New Guidelines, a market may be defined in terms of goods (including services); geographical scope of transactions; stages of trade; and extremely large counter-parties (i.e. large accounts). The JFTC will identify all the goods of the businesses which compete with one another and then determine the scope of such competition, after which the geographical and other factors will be applied. The scope of a certain good is determined in terms of its function and efficacy to users. Very simply, if, when the price of product X is increased, users of product X purchase product Y, then products X and Y are held to be in the same market. This method of defining a market seems similar to the SSNIP (small but significant and non-transitory increase in price) Test used in the US.

iii) Safe harbours

The JFTC expanded the scope of safe harbours in the New Guidelines largely in response, we understand, to the suggestions of the METI. More specifically, the New Guidelines introduced the notion of the HHI (Herfindahl-Hirschmann Index) as a measure of the extent of oligopoly, where a post-M&A HHI below 1,800 is "not highly oligopolistic" and a post-M&A HHI below 1,000 is "not oligopolistic." The New Guidelines further state a safe harbour exists where: (a) post-M&A market share is 10% or less; or (b) (i) the market is not oligopolistic, and (ii) post-M&A market share is 25% or less.

Previously, the Old Guidelines stated a safe harbour existed, without adopting HHI, where: (a) post-M&A market share was 10% or less; or (b') (i) the market was not oligopolistic, (ii) post-M&A market share was 25% or less, (iii) market entry (including importation) was easy, (iv) the post-M&A party was not the largest shareholder, and (v) competition in the relevant market had not been fierce. Thanks to introduction of HHI and the abandonment of certain factors (compare (b) and (b') above), predictability has experienced a significant improvement.

iv) "The effects may be substantially to restrain competition"

The New Guidelines cite case law from 1953 by which to interpret the term "substantial restraint of competition," which is criticized as not appropriate and not helpful. However, in practice, the ensuing portion of the New Guidelines and prior JFTC decisions illustrate that the JFTC will find a "substantial restraint of competition" where a reasonable possibility exists that (i) the post-M&A party can raise the prices of goods without deterrence by the competitors ('unilateral conduct'); or (ii) that the post-M&A party or its competitor can easily raise prices for the goods thanks to the predictability of the behaviour of competitors ('coordinated conduct'). In judging whether situation (i) or (ii) above exists, the following factors will be taken into consideration: (a) the position of the corporate group and competitors; (b) import; (c) new entry; (d) competitive pressure from neighboring markets; (e) overall business capabilities; (f) efficiency; and (g) the financial conditions of the parties.

With regard to criterion (a) (the position of the corporate group and competitors), the New Guidelines state, with a certain reservation, a "substantial restraint of competition" is unlikely to arise from unilateral conduct where: (i) the market is not highly oligopolistic (i.e. HHI of less than 1,800), the post-M&A market share is 25% or lower and there is a competitor with market share of 10% or higher; (ii) the market is not highly oligopolistic, the post-M&A market share is 35% or lower, and there are two or more competitors with a market share of 10% or higher; or (iii) the incremental market share is very small (i.e. HHI increment is less than 100) and there is a competitor with a market share of 10% or higher.

v) Remedy

Even if the proposed M&A may result in a "substantial restraint of competition", if certain remedial measures offered by the parties (occasionally in response to JFTC's suggestions) are taken, the JFTC may clear the merger. Such "remedies" were sometimes used in prior consultations before the implementation of the New Guidelines, but they formally introduced such a system for the first time. In the past, remedies were one of the most uncertain issues regarding the JFTC's review process[3] and therefore it is noteworthy that the New Guidelines publicly disclosed JFTC's view of remedies.

Under the New Guidelines, remedies must be carried out before an M&A is closed. Where remedies are carried out after closing, the deadlines for their implementation must be appropriately and specifically established. The New Guidelines also contain examples of possible remedies, such as business transfer, partial dissolution of affiliates, measures to enhance product importation and new entry.

vi) Summary

It appears that the New Guidelines draw upon the inspiration of the past practice of the JFTC. However, the chief significance of the New Guidelines is the public adoption and dissemination of certain unwritten rules and practices of the JFTC. This is certain to contribute to the future predictability of M&A proposals submitted to the JFTC.[4]

Practical guidance regarding scheduling of informal prior consultations

While it is true that the standards by which the JFTC conducts M&A reviews are clearer after the introduction of the New Guidelines, the importance of the prior consultation remains unchanged, especially where the findings of the JFTC cannot be easily foreseen. Due to their practical importance, we will expand on the scheduling issues for prior consultations.

As mentioned earlier, the *Policy Regarding Accepting Prior Consultation on M&A Plans* was implemented in 2002 to make the process quicker and more transparent. The policy stated that (i) the JFTC will notify parties either that a merger is permissible under the AMA or that a detailed review will be necessary, generally within 30 days from the submission date of the M&A materials; that (ii) in case of a detailed review, the JFTC will issue a public notice and seek comments from the general public for 30 days after the issuance of the notice; and (iii) that the JFTC's decision and the reasons therefor shall be provided generally within 90 days of the provision of all the materials necessary for a detailed review.[5]

The periods stipulated in (i) and (iii) above are calculated from the submission of all the necessary materials. Even if detailed review is not involved, given that the parties are normally asked to submit materials in addition to the materials originally submitted to the JFTC on the date the parties initiate the prior consultation, it stands to reason that, in practice, it is difficult to complete a prior consultation process within 30 days of the first meeting. Therefore, where a certain M&A transaction must be completed on or before a certain date, the parties must prepare a schedule to accommodate the time needed to prepare the additional materials. On the other hand, in order for the parties to

initiate prior consultation proceedings with the JFTC, it is considered that the discussions between the parties should not be "premature." We understand that entering into a MOU is unnecessary, but rather the presence of good faith intention to enter into a MOU would be sufficient in order for the parties to ask the JFTC to initiate prior consultation.

Finally, if an M&A is proposed between Japanese companies whose operations are conducted internationally, the best practice is to first receive the clearance from the JFTC. Thereafter, the fact that the JFTC cleared the transaction can be used to bolster the argument that the competition authorities of other jurisdictions should do so as well. Where such consideration is applicable, a schedule should be prepared bearing such in mind.

Conclusion

On January 24 2005, the JFTC announced that Tokai Carbon and Mitsubishi Chemical had abandoned their plan to integrate their carbon black businesses after prior consultation. According to the JFTC press release, the JFTC reviewed their plan based upon the New Guidelines and concluded that it would have resulted in a substantial restraint of competition by virtue of both unilateral conduct and coordinated conduct. The parties abandoned their plan after considering possible remedies. Combined market share, post-M&A HHI and HHI increment in two of the relevant markets were 45%, 3,100 and 900 and 40%, 2,600 and 850, respectively.

Recently, criticism was levied at the JFTC for its "lenient" clearances, particularly in the Japan Airlines and Japan Air Systems case in 2002 and the business transfer of RJR Nabisco's tobacco business (excluding the US division) to Japan Tobacco in 1999; both of which were reviewed under the Old Guidelines. While it is unclear if the Tokai Carbon/Mitsubishi Chemical case shows a 'change in the tides,' it may be worthwhile and interesting to keep watching the movements at the JFTC. In the end, it seems only hindsight will show how much the JFTC's practice has been actually affected by the introduction of the "clearer" New Guidelines.

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Endnotes

1 *See* http://www2.jftc.go.jp/e-page/legislation/ama/ama.pdf

2 An English-language guide for foreign companies is available at http://www2.jftc.go.jp/e-page/legislation/ama/MAnotification.pdf

3 *See* Japan Airlines and Japan Air Systems case (2002).

4 Anyone with a keen interest in merger control in Japan may wish to read the New Guidelines, which can be found at JFTC's website: http://www2.jftc.go.jp/e-page/legislation/ama/MAreview.pdf

5 The 30-day period mentioned in (i) above may be shortened to 15 days if the *Review of Mergers and Acquisitions Regarding Revitalization of Companies and Industries* is applicable.

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About the firm

The Japanese law firms of Anderson Mori and Tomotsune & Kimura merged their law practices as of January 1 2005. The name of the merged firm is Anderson Mori & Tomotsune, with principal offices located in Izumi Garden Tower, 6-1, Roppongi 1-chome, Minato-ku, Tokyo 106-6036, Japan. The combination of practices enables Anderson Mori & Tomotsune to provide an even higher level of legal services in a broader number of practice areas, with enhanced capability to handle extremely large and complex transactions such as large M&A and finance projects, global securities offerings and other cross-border investment transactions.

The firm currently has approximately 180 Japanese attorneys (bengoshi). All attorneys at Anderson Mori & Tomotsune are fluent in English and almost all its partners and senior associates have obtained accreditation and training overseas in the United States, Australia or the United Kingdom. In addition, the merged firm has over 10 foreign attorneys licensed to practice in common law jurisdictions, including one US attorney licensed as a foreign lawyer qualified to practice in Japan (Gaikokuho Jimu Bengoshi). The Tokyo offices of Anderson Mori & Tomotsune also has the support of a Japanese patent attorney and a Chinese lawyer licensed to practice in China. The firm also provides services from its Beijing office, as a natural outgrowth of its commitment to serving domestic and foreign clients with respect to all aspects of business law in Asia, including clients with new and existing business in China.

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