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Japan: Merger Control

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Merger control was introduced in Japan by Law No. 54 of 1947, as amended, otherwise known as the Anti-Monopoly Act (AMA), at the same time as Japan's first competition rules. The Japan Fair Trade Commission (JFTC) has primary jurisdiction over the enforcement of merger control under the AMA. The AMA provides two types of regulations for business combination:

- a formalistic regulation that requires a prior notification for transactions that satisfy the relevant thresholds; and
- a substantial regulation that prohibits a business combination that will result in restraint of trade in a particular field of trade (relevant market).

Prior notification requirement

Transactions to be notified

Mergers, business transfers, corporate splits (or demergers) and stock acquisitions (M&A transactions) are subject to prior notification under the AMA. M&A transactions whose schemes involve more than one of these transactions (eg, where an acquirer merges with a target after acquiring shares in the target) are separately analysed at each step of the transaction, so separate filings may, in principle, need to be made for the various steps. Joint ventures are also analysed in the same way.

If the M&A transactions satisfy certain thresholds, they are subject to a prior notification obligation. Generally, M&A transactions within the same combined business group are exempted from the prior notification requirement.

In 2013, the JFTC changed its practice with regard to mergers. Under the new practice, in case of an absorption-type merger where Company A merges into Company B and shares of Company B will be issued to the shareholders of Company A, the JFTC requires a notification of a merger between Company A and Company B as well as a notification of stock acquisition by the shareholders of Company A. This change will have a huge impact on the practice because it will increase the burden of the parties in the case of mergers.

Thresholds for notification

Amendment to the thresholds

The thresholds for notification were amended as of 31 January 2010, from the previous general thresholds of ¥10 billion and ¥1 billion, to the new general thresholds of ¥20 billion and ¥5 billion thresholds. Because of the higher thresholds, the number of transactions notified to the JFTC has decreased rapidly since the amendment. According to the 'Major Business Combinations in FY 2011' report published by the JFTC on 20 June 2012, the 'Major Business Combinations in FY 2012' report published by the JFTC on 5 June 2013 and the 'Major Business Combinations in FY 2013' report published by the JFTC on 11 June 2014, the number of filings after FY 2009 is as follows:

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Number of filings	985	265	275	349	264

Stock acquisitions

A stock acquisition will require prior notification if the stockholding ratio after the transaction rises above 20 per cent or 50 per cent and the following threshold is satisfied.

	Threshold
Acquiring corporation	The aggregate domestic sales of all corporations within the same combined business group as the acquiring corporation exceed ¥20 billion.
Target corporation	The aggregate domestic sales of the target corporation and its subsidiaries exceed ¥5 billion.

Business transfer

The filing thresholds for business transfers (including asset transfers) are as follows.

Transfer of whole business	
	Threshold
Acquiring corporation	The aggregate domestic sales of all corporations within the same combined business group as the acquiring corporation exceed ¥20 billion.
Transferring corporation	The domestic sales exceed ¥3 billion.

Transfer of (i) a substantial part of the business or (ii) the whole or a substantial part of the fixed assets used for the business	
	Threshold
Acquiring corporation	The aggregate domestic sales of all corporations within the same combined business group as the acquiring corporation exceed ¥20 billion.
Transferring corporation	The domestic sales attributable to the transferring business exceed ¥3 billion.

As can be seen, the transfer of the whole of the business and the transfer of a substantial part of the business or the whole or a substantial part of the fixed assets used for the business are both subject to different sets of filing thresholds.

Mergers and corporate splits

The filing thresholds for mergers are as follows:

- the aggregate domestic sales of all corporations within the same combined business group as one of the merging companies must exceed ¥20 billion; and
- the aggregate domestic sales of all corporations within the same combined business group of one of the other merging companies must exceed ¥5 billion.

The filing thresholds for corporate splits vary depending on the structure of the split, but essentially the ¥20 billion and ¥5 billion thresholds apply.

Domestic sales

As can be seen from the above, domestic sales is a decisive factor in the threshold. Domestic sales is defined as the total amount of prices of goods or services supplied in Japan during the latest fiscal year (article 10, paragraph 2 of the AMA). According to the 'Rules on Applications for Approval, Reporting, Notification, etc. Pursuant to articles 9 to 16 of the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade', published by the JFTC (the Merger Rules), domestic sales of Company X include the sales amount accrued through direct importing to Japan, and more precisely will be the total amount of the following three categories of sales (article 2, paragraph 1 of the Merger Rules):

- the sales amount of goods with respect to which domestic consumers (individuals excluding those who are transacting for business) are the purchasers;
- the sales amount of goods to be supplied in Japan with respect to which corporations or other business entities or individuals who are transacting for business (business entities) are the purchasers (provided, however, that the sales amount of goods which Company X knows, at the time of entering into the relevant contract, will be further shipped outside Japan without any changes in their nature or physical appearance should be excluded); and
- the sales amount of goods to be supplied outside Japan with respect to which business entities are the purchasers and which Company X knows, at the time of entering into the relevant contract, will be further shipped to Japan without any changes in their nature or physical appearance.

The same threshold will be used regardless of the jurisdiction in which the acquiring corporation or the target corporation was established. It should be noted that if the Company X is a company obliged to submit financial statements (article 5, paragraph 1, Item 1 of the Rules regarding the Terms, Forms and Preparation Methods of Financial Statements, etc), it may substitute the value as determined pursuant to the Merger Rules as their domestic sales (article 2, paragraph 2 of the Merger Rules).

It should also be noted that the Merger Rules have a provision to allow flexibility where the strict calculation of domestic sales in accordance with the Merger Rules is not possible, in which case it is permitted to use a different method to calculate the amount of domestic sales so long as it is in line with the purpose of the above method and in accordance with generally accepted accounting principles (article 2, paragraph 3 of the Merger Rules).

Combined business group

The combined business group consists of all of the subsidiaries of the ultimate parent company. It should be noted that a corporation will be considered to be a subsidiary not only when more than 50 per cent of the voting rights of the corporation are held by another corporation, but also if its management is 'controlled' by the other corporation (article 10, paragraph 6 of the AMA). The Merger Rules specify a detailed threshold for 'control', which might be found to be met even if the ratio of beneficially-owned voting rights is 50 per cent or below. The concept of 'control' as used to decide the scope of subsidiaries is in line with the concept of 'control' as used to define group companies under the Ordinance for the Enforcement of Companies Act, and therefore it is not a totally new concept. However, it should be noted that it is a concept slightly different from the concept of 'control' under the regulations for financial statements. Moreover, according to a reply by the JFTC to public comments announced on 23 October 2009, the scope of the 'combined business companies' should be decided immediately before the closing of the transaction. Therefore, it may not be possible to use the list of group companies as written in the relevant financial statements, and companies should at least check whether the list of group companies is exactly the same as requested by the Merger Rules, which could take considerable time depending on the complexity of the corporate structure of the company in question.

Waiting period

M&A transactions are subject to a standard 30-day waiting period (or if such period is shortened, within the shortened period). The JFTC may request additional information during such period. If the JFTC considers that the contemplated M&A transaction has an anti-competitive effect and therefore intends to order certain necessary measures be taken, it will notify the party within the 30-day waiting period, or if the JFTC requested additional information, within the longer period of either 120 days from the date of receipt of the initial notification or 90 days from the date of the receipt of all of the additional information. If the JFTC considers that the contemplated M&A transaction does not have an anti-competitive effect, it will provide a clearance letter to the party within the above mentioned period. In addition to the statutory waiting period, it takes some time for the parties to prepare a draft notification by collecting, for example, market data; and for the JFTC to check the draft and to formally accept the notification. If the M&A transaction has any anti-competitive effect, the period necessary to consult with the JFTC prior to the notification also needs to be taken into consideration. In practice, it normally takes one to two months for such preparation even where the M&A transaction does not have any anti-competitive effect. If the M&A transaction has any anti-competitive effect, the preparation takes longer (ie, approximately two to six months).

Substantive test

The nature of the substantive test for the assessment of mergers

It is important to note that the JFTC can theoretically review any M&A transaction under the substantive test, regardless of whether or not the thresholds described above are met. The substantive test for clearance is whether the proposed M&A transaction may result in a 'substantial restraint of competition in a particular field of trade'. The Guidelines to Application of the Antimonopoly Act Concerning Review of Business Combination (the Merger Guidelines) provide guidance as to the substantive test.

Regarding market definition, the Merger Guidelines adopt the so-called small but significant and non-transitory increase in price (SSNIP) test for the purposes of analysing demand and supply substitution. Importantly, the Merger Guidelines clarify that the geographic market may be wider than the geographic boundaries of the territory of Japan, depending upon the international nature of the relevant business. In some cases, the JFTC has actually defined the relevant market as the global market, in cases such as the market for magnetic heads (acquisition of fixed assets for magnetic head manufacturing from Alpus Electric Co, Ltd by TDK Corporation), the markets relevant for semi-conductors such as SRAM, MCUs, LCD drivers, transistors and thyristors (merger of NEC Electronics Corporation and Renesas Technology Corporation) and HDD (consolidation plan of manufacturing and sales companies of hard disk drives). In addition, the Merger Guidelines explain the factors that

will be taken into account when assessing whether a certain M&A transaction substantially restrains competition in a relevant market. The substantive test is analysed in each case for horizontal, vertical and conglomerate M&A transactions. Perhaps the most interesting feature of the Merger Guidelines is the use of 'safe harbours' for each of the three categories of M&A transactions identified above (specific harbours apply to each category) as part of the substantive test analysis. These are cases where the JFTC normally considers that there is no possibility that there may be a substantial restriction of competition or that such possibility is small and accordingly it is not necessary to conduct a detailed examination of the M&A transaction. Each case is, however, reviewed on its own merits, and the application of the harbours needs to be analysed carefully within the specific context of each transaction.

Safe harbours

Safe harbours for horizontal M&A transactions

In case of horizontal M&A transactions, if any of the following three conditions is satisfied (and there are no other competitive restrictions) the JFTC is likely to consider that the M&A transaction does not substantially restrain competition in a relevant market:

- the Herfindahl-Herschmann Index (HHI) after the M&A transaction is not more than 1,500;
- the HHI after the M&A transaction exceeds 1,500 but is not more than 2,500, and the HHI does not increase (the so-called delta) by more than 250; or
- the HHI after the M&A transaction exceeds 2,500 and the delta is not more than 150.

If none of the above safe harbours are met, the JFTC will proceed with a (separate) analysis of the non-coordinated (unilateral) and coordinated effects of the horizontal M&A transaction. However, the amendments to the Merger Guidelines clarify that based on the JFTC's past experience, if the HHI after the completion of the M&A transaction is not more than 2,500 and the combined market share does not exceed 35 per cent, it is generally considered that there is a low possibility that the M&A transaction will substantially restrain competition.

Safe harbours for vertical and conglomerate M&A transactions

The Merger Guidelines identify two safe harbours for vertical and conglomerate M&A transactions. If any of the following conditions are met (and there are no other competitive restrictions), the JFTC is likely to consider that the M&A transaction does not substantially restrain competition in a relevant market:

- the merging parties' market share after the M&A transaction is not more than 10 per cent; or,
- the merging parties' market share after the M&A transaction is not more than 25 per cent and the HHI after the M&A transaction is not more than 2,500.

If neither of the above safe harbours is met, the JFTC will proceed with a (separate) analysis of the non-coordinated (unilateral) and coordinated effects of a vertical or conglomerate M&A transaction in the same way as for horizontal M&A transactions. However, the Merger Guidelines clarify that, if the HHI after the M&A transaction is not more than 2,500 and the merging parties' market share after the M&A transaction is not more than 35 per cent, it is generally considered that the possibility of the M&A transaction resulting in substantially restrained competition is low.

Justification – in case a M&A transaction does not satisfy the safe harbour

Analysis of unilateral and coordinated effects of horizontal M&A transactions

The Merger Guidelines specify the following factors as the determining factors in examining the unilateral effects of a horizontal M&A transaction:

- the position of the company group and the competitive situation – market shares and market share ranks, competition among the parties, etc, in the past, market share differences between the competitors and the party, competitors' excess capacity and degree of differentiation of products;
- import – degree of institutional barriers to import products, degree of import-related transportation cost and existence of problems in distribution, degree of substitutability between the imported product and the parties' product, and whether it is feasible to supply from overseas;
- entry – degree of institutional barriers to enter the market, degree of practical barriers to enter the market, degree of substitutability between entrants' product and the parties' products, and potential entry pressure;
- competitive pressure from adjacent markets – what are competing goods, and situation of the geographically adjacent market;
- competitive pressure from users – competition among users and easiness to change suppliers;
- overall business capabilities; and
- efficiency – whether the M&A transaction improve efficiency, whether the improvements in efficiency is achievable and whether the improvements in efficiency contribute to the interests of users.

The Merger Guidelines also specify the following factors as the determining factors in examining whether a horizontal M&A transaction may be substantially restrain competition in a relevant market through coordinated conduct:

- the position of the company group and the competitive situation – number of competitors, competition among the parties etc in the past, excess capacity of competitors;
- actual condition of trade – easiness to obtain information regarding price and quantity of the competitors' trade, trends in demand and technological innovation, and past competitive situation;
- competitive pressure from import, entry and adjacent markets, etc; and
- efficiency – whether the M&A transaction improves efficiency, and whether the improvements in efficiency are achievable or contribute to the interests of users.

Failing-firm defence

The failing-firm defence is available under the Merger Guidelines as a defence to a horizontal M&A transaction. The Merger Guidelines stipulate that the possibility that the effect of a horizontal business combination may substantially restrain competition is usually small if:

> *[a] party to the combination has recorded continuous and significant ordinary losses or has excess debt or is unable to obtain finance for working capital and it is obvious that the party would be highly likely to go bankrupt and exit the market in the near future without the business combination. Moreover, it is difficult to find any business operator that can rescue the party with a combination that would*

have less impact on competition than the business operator that is the other party to the combination.

Based on this failing-firm defence, the JFTC cleared the proposed acquisition of shares of Showa Aluminium KK by Toyo Aluminium KK (press release of the JFTC on 28 December 2010).

Prior consultation procedure

Before June 2011, a prior consultation procedure was available for parties, under which the parties could consult with the JFTC about substantive issues relating to the M&A transactions before a formal filing of the notification. As of 1 July 2011, however, the JFTC abolished the prior consultation procedure and introduced a new system by implementing policies concerning procedures of review of business combination. Under the old system, if a party requested a prior consultation, the JFTC started to review the substantive issues and provided its preliminary view on the transaction. The idea under the new system is, however, that, at the pre-notification stage, the JFTC provides consultation only as to how to fill in the notification form, and only after the formal notification will the JFTC start to review the substantive issues. In addition, the communication between the parties and the JFTC is enhanced under the new system. For example, the parties are permitted to request that the JFTC explain any issues in relation to the proposed M&A transaction at any time during the review period and it is further possible for the parties to submit opinions to the JFTC (including a proposal for remedies).

Under this new system, when a party plans to implement an M&A transaction that may raise substantive issues, the party may first consider consulting with the JFTC at the pre-notification stage. The consultation system at the pre-notification stage is mainly to assist parties with filling in the notification form, but since the notification form includes some items that are crucial for substantive issues, such as market definition and market share, the parties may discuss substantive issues with the JFTC in connection with such items. The party can also proactively communicate with the JFTC, for example, by requesting the JFTC to explain certain issues in order to understand concerns at an early stage and by submitting its written opinions as to how it plans to address such concerns.

For example, in the case of the merger between Nippon Steel and Sumitomo Metal on 1 October 2012, the parties actively communicated with the JFTC. In this case, prior to the formal notification on 31 May 2011, the parties voluntarily submitted a written opinion to the JFTC stating that the merger would not substantially restrain competition from March 2011 and the JFTC also held several meetings with the parties at the request of the parties.

Foreign-to-foreign transactions

After the amendment to the AMA effective as of 31 January 2010, the thresholds capture domestic sales by a foreign company that does not have a subsidiary in Japan and any foreign-to-foreign transactions should be notified so long as they satisfies the thresholds.

It appears that the JFTC will not hesitate to investigate a foreign-to-foreign transaction if it will result in substantial restraint in trade. As we mentioned above, the JFTC may open investigation when it finds substantive issues, regardless of whether the transaction satisfies the notification thresholds or not. For example, in 2008, the JFTC opened investigations in relation to the acquisition by BHP Billiton of shares issued by Rio Tinto, which was a purely foreign-to-foreign transaction, and actively investigated the transaction.

In order to facilitate the investigation of international transactions, the JFTC has entered into an antimonopoly cooperation agreement with each of Canada, the European Community and the United States. In addition, the JFTC entered into economic partnership agreements with various countries such as Peru, India, Switzerland, Vietnam, Indonesia, Thailand, Chile, Philippines, Malaysia, Mexico, and Singapore.

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Hideto Ishida counsels a variety of domestic and foreign multinational companies in Japanese antitrust and competition matters, including those relating to mergers and acquisitions, joint ventures, distribution agreements, licence agreements and other cooperation agreements. He also represents many companies involved in investigations before the JFTC and other foreign competition authorities for price cartels, bid rigging and similar serious alleged violations such as vitamin, graphite electrode, GIS, marine hose, air fare and LCD international cartels. He served for seven years as the first attorney appointed as a special investigator with the JFTC and thus has a keen sense of the actual and practical application of antitrust and distribution regulations to companies doing business in Japan.

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