ANTITRUST CONSIDERATIONS IN JAPAN M&A TRANSACTIONS (AND MORE)

By Stephen D. Bohrer and Madoka Shimada

Stephen D. Bohrer is a Partner at Nishimura & Asahi and a leader of the firm's Cross-Border Transactions Group. Madoka Shimada is a Partner at Nishimura & Asahi. Contact: s.bohrer@nishimura.com or m.shimada@nishimura.com.

Critics of antitrust enforcement in relation to M&A transactions raise concerns that regulators sometimes overreach by scrutinizing transactions that actually do not harm competition. Pundits may further argue that evaluating the harmful competitive effects arising from an M&A transaction can be subjective and based on regulatory/political bias, which makes antitrust enforcement less predictable. When completing a deal becomes less predictable, transaction parties may elect to abandon a transaction or implement overly aggressive deal tactics to reduce the likelihood of antitrust challenges (such as carving out from the transaction certain businesses, constructing high information sharing barriers, and severely limiting the ability of a purchaser to preserve the value of the target company pending closing). The consequences of the foregoing can lead to the loss of worthwhile opportunities for companies and consumers, greater deal execution delays, and higher transaction costs. While Japanese antitrust laws and regulations are strict, a purchaser accustomed to hyper-enforcement or a rapidly changing antitrust environment in its home country should be pleased to learn that Japanese antitrust enforcement is relatively manageable. With more predictable antitrust execution risks, deal makers contemplating the acquisition of a Japanese company should be able to better manage regulatory challenges and budget costs to acquire a Japanese company with only domestic turnover.

This article discusses three critical aspects in an M&A transaction that are influenced by Japanese antitrust laws (the latter two often apply to transactions outside of Japan, so their basic tenets are relevant on a global level, too): (i) antitrust filing requirements and regulatory scrutiny; (ii) gun-jumping and the implementation of permissible interim operating covenants on a target company, and; (iii) the sharing of highly confidential business information with the purchaser prior to closing. This article aims to provide the legal basis and theoretical justification for certain antitrust requirements and procedures, and debunks antitrust tactics that may be proposed by a counter-party that are seemingly unnecessary for the acquisition of a Japanese company (or other local company) with only domestic turnover.

Antitrust Filings

A Japan antitrust filing is required if either certain numerical tests are satisfied, or there is a subjective belief by the Japan Fair Trade Commission (the "JFTC") that a proposed transaction will unfairly impede local competition.

Each trigger is discussed below, followed by a review of JFTC scrutiny of notified transactions.

Numerical test trigger. M&A transactions that meet certain numerical thresholds require the submission of a mandatory pre-closing filing with the JFTC, upon which the JFTC will consider the competitive effects of the proposed deal. The Annex below (see p. 12) sets forth the thresholds depending on the form of the transaction (but does not take into account industry-specific rules, such as those applicable to banking and insurance). A filing must be submitted to the JFTC before the closing of the transaction, and transactions that will be completed over multiple steps (*e.g.*, a triangular merger) may require a filing at each stage. There are no other statutory requirements with respect to the precise timing for a filing, and it can be submitted prior to the execution of definitive acquisition documentation (however, submitting pre-signing antitrust filings are rare in Japan, similar to the United States). No fees are payable to the JFTC in connection with the submission and its review of an antitrust filing, even if a further request for information is made by the JFTC (*i.e.,* a so-called Phase II review).

There is a 30-calendar-day waiting period after the JFTC accepts a filing, during which the transaction cannot close. The JFTC can reduce the waiting period if it considers a shorter waiting period is appropriate (which generally speaking can be shortened to as little as two weeks after a filing is accepted by the JFTC). If the JFTC determines that it is necessary to conduct a more detailed review of the transaction, then it will initiate a Phase II review by officially requesting the filing party or parties to submit further detailed information.

When determining whether to block a notified transaction, the JFTC considers whether the horizontal, vertical or conglomerate effects of a transaction will "substantially restrain competition" in any relevant market. A substantial restraint of competition is considered to have occurred when the state of competition has significantly decreased or when a specific business operator (or a group of business operators) can unilaterally determine prices, quality, volumes and various other sales terms.

An important part of the above analysis is the use of safe harbors measured by the Herfindahl-Hirschman Index ("HHI"). In the safe harbor analysis, the JFTC is likely to consider that a notified transaction does not substantially restrain competition if any of the following conditions are satisfied:

- *Horizontal transactions*: (i) the HHI after the transaction is not more than 1,500, (ii) the HHI after the notified transaction exceeds 1,500, but is less than 2,500, and the increased HHI (delta) is not more than 250; or (iii) the HHI after the transaction exceeds 2.500, and the increased HHI (delta) is not more than 150.
- *Vertical and conglomerate transactions*: (i) the merging parties' market share after the transaction is not more than 10%; or (ii) the merging parties market share after the transaction is not more than 25% and the HHI after the transaction is not more than 2,500.

Subjective standards trigger. Even if a transaction does not require the submission of a mandatory pre-closing filing with the JFTC because the enumerated numerical thresholds are not satisfied, the JFTC may nonetheless conduct a substantive review of the competitive effects of a transaction at any time if the combined market share of the parties does not reflect their potential anti-competitive significance (*e.g.*, the completion of the transaction would provide the purchaser with unparalleled access to important data or intellectual property). The JFTC may even consider the anti-competitive effects of a non-reportable transaction after the closing. In December 2019, the JFTC published an amendment to its policy on reviewing business combinations and clearly stated its interest to review M&A transactions that have a large value and are likely to affect Japanese consumers (but are not reportable to the JFTC because they do not meet the enumerated numerical thresholds that mandate a filing). The amendment encourages transaction parties to consult with the JFTC for non-reportable transactions if the transaction value is greater than JPY 40 billion (approximately $265 million), and other specified factors are satisfied. Accordingly, transaction parties engaging in a large unreportable transaction should consult with legal counsel to assess whether a consultation with the JFTC (and a voluntary antitrust filing) is advisable in order to avoid potential post-closing scrutiny by the JFTC.

Filing history and regulatory scrutiny. While antitrust filings are commonplace in Japan, few transactions are subject to in-depth JFTC scrutiny. Over the period of April 1, 2022, through March 31, 2023, 306 antitrust filings were accepted by the JFTC, of which 299 were granted clearance upon the initial review and no case was subject to a Phase II review. Of the 306 notified transactions, 15 were voluntary filings and seven cases were withdrawn by the parties before the end of the initial review phase. Over this same period, the JFTC did not publicly disclose that it launched an investigation into a non-reportable transaction (but it is conceivable that the JFTC made private inquiries). Furthermore, for over 50 years the JFTC has not issued a cease-and-desist order to block a transaction (however, in practice, unsuccessful cases are normally withdrawn by the parties).

Gun-Jumping

Gun-jumping typically occurs in most jurisdictions (not only in Japan) through two types of unlawful pre-merger coordination scenarios between M&A transaction parties. First, gun-jumping in Japan can occur when a purchaser engages in conduct that prematurely confers to it beneficial ownership over a target company. This unlawful ownership shift can occur when (i) the deal closes too soon (*i.e.*, in Japan, before the expiration of the 30-day antitrust waiting period), or (ii) the acquisition agreement provides the purchaser with too much control over the target company's business before the antitrust waiting period expires. The latter can occur through the application of restrictive interim operating covenants in the acquisition agreement that provide the purchaser with veto rights over certain activities of the target company. Second, gun-jumping can occur even after the expiration of the antitrust waiting period if the purchaser and the target company are competitors because peer firm joint coordination prior to closing can be viewed under Japanese antitrust laws and others as an unreasonable restraint of trade. For example, this type of gun-jumping can involve price fixing, customer allocation, and the sharing of "competitively sensitive information" (as discussed below).

A gun-jumping violation in Japan can be pursued only by the JFTC. There is no private right of enforcement in Japan. If no antitrust filing is required and there is no overlap in the businesses of the purchaser and the target company, then gun-jumping is normally not a concern in Japan.

To date, the risk of being sanctioned for a gun-jumping violation in Japan is only theoretical. The JFTC has never publicly issued gun-jumping administrative guidance or penalized transaction parties due to a gun-jumping violation (though the JFTC issued a statement of warning in 2016 that the warrant structure used by Canon to acquire Toshiba Medical could be a circumvention of Japanese antitrust laws and warned against the further use of such structure). The foregoing absence does not mean that a gun-jumping violation cannot occur in Japan. Instead, the likelihood of a gun-jumping violation is low based on the JFTC's historic antitrust enforcement focus, but its occurrence cannot be completely ignored.

While definitive guidance is not possible given the absence of public JFTC guidance on unlawful gun-jumping activities, if there is the potential for a gun-jumping concern, then prudence suggests (not only in Japan) that prior to closing a purchaser should not be able to (i) allocate customers or agree that the target company will not bid on a job or contract (or otherwise limit the target company's ability to compete for customers), (ii) require its consent in order for the target company to engage in ordinary business transactions, such as the pricing of goods, marketing campaigns, product development, procurement, or the selection of customers, (iii) block all capital expenditures or intellectual property licensing by the target company, or (iv) transfer personnel from one party to the other. If a monetary threshold is applied to certain actions taken by the target company (such as incurring indebtedness, entering into customer agreements or undertaking capital expenditures in excess of a stipulated amount), then the threshold should be set above the average level of the target company's historic practices to avoid having the purchaser involved in routine business decisions of the target company. The scope of permissible restrictive interim operating covenants should be reduced or even eliminated if the purchaser and the target company are competitors given the necessity of competitive independence until a transaction closes.

A purchaser has a legitimate commercial and practical interest in ensuring that a seller does not unduly dissipate the value of the target company during the pendency of an acquisition, and that the purchaser can promptly commence combined business activities after the closing. To that end, we expect that the JFTC is agreeable to post-signing covenants designed to protect that value. Nonetheless, local advisors may develop gun-jumping guidelines for the acquisition of a Japanese company with only domestic turnover based on their perception of best practices and international standards to avoid serving up a test gun-jumping case for JFTC action. While adopting a risk adverse approach to a potential antitrust violation is prudent, at the same time, a purchaser should be skeptical given the paucity of Japanese regulatory and court action in this area if a seller refuses to accept a restrictive interim operating covenant after the expiration of the 30-day Japan antitrust waiting period where there is no competitive overlap based solely on a perceived Japanese antitrust concern. A purchaser should have a winning counter-argument if it can offer a reasonable and legitimate business or integration reason for the proposed curb in the target company's pre-closing activities.

Clean Teams

A clean team structure is formed to address a gun-jumping concern where the purchaser and the target company are competitors and need to share highly confidential information as part of the due diligence process prior to the consummation of the deal. Antitrust agencies take the view that competitive harm can arise from the sharing of "competitively sensitive information" (as discussed below) similar to the harm caused by an anti-competitive transaction and, until the deal closes, the parties should continue to operate as independent businesses and safeguard their competitively sensitive information to ensure competition. Under a clean team structure, therefore, an information barrier is established to prevent the flow of highly confidential information to individuals who could use such information in an anti-competitive way.

In a clean team structure, competitively sensitive information is typically placed in a separate data room file or "Clean Room," with access limited electronically to clean team members. The clean team members can review competitively sensitive information and prepare reports that summarize and/or aggregate information for other team members so competitively sensitive information is not directly disclosed to the non-clean team members of the purchaser. Typically, antitrust counsel reviews the reports to ensure compliance. The seller often prepares a clean team agreement setting forth the rules for establishing the clean team, the procedures for sharing information, the restrictions on clean team members if the transaction fails, and the consequences of breaches.

Establishing an effective clean team structure in Japan and other jurisdictions rests upon navigating the following streams: (i) the relationship of the transaction parties, (ii) the definition of competitively sensitive information, and (iii) the scope of persons eligible for clean team membership.

Each is discussed below:

Relationship of the transaction parties. Exchanging highly sensitive confidential information, particularly if the purchaser and the target company are horizontal competitors, could lead to collusion prior to the closing of an M&A transaction and should be avoided. However, if there is a vertical relationship between the purchaser and the target company (such as the target company is a supplier to the purchaser), then it is rebuttable whether a formal clean team arrangement is necessary in Japan.

In a vertical relationship, a seller may argue a clean team is necessary because the purchaser could learn key pricing and other supply terms available to other customers that could benefit the purchaser's own business. On its face, however, the likelihood of creating a collusive environment in a vertical relationship is not entirely clear. There also are no JFTC regulations and Japanese court cases for when a clean team should be established, so a purchaser may consider challenging a seller's request to automatically implement a clean team structure simply because there is a vertical relationship between the parties. Ultimately, the decision to form a clean team may not be made solely on legal principles, but on bargaining leverage (especially if the acquisition is structured as an auction, which normally provides the seller with great latitude).

Definition of competitively sensitive information. The JFTC recognizes that a purchaser has a legitimate need to engage in due diligence to assess value, identify potential liabilities, and explore potential synergies. The agency ordinarily will not challenge the exchange of typical due diligence materials, such as information relating to the target company's finances, products, plants, facilities, environmental exposure and litigation risk. On the other hand, the JFTC may challenge the exchange of "competitively sensitive information" depending on the relationship between the target company and the purchaser (as discussed above).

There is no definition of "competitively sensitive information" under JFTC regulations or Japanese case law. Instead, the term has evolved through legal practitioners' views on what highly confidential business information concerning a target company's business could be utilized by a purchaser to benefit its day-to-day business operations or thwart competition.

In light of the foregoing, there is no exhaustive list of what information is considered competitively sensitive. The scope of such information is a facts and circumstances test based on the business activities of the target company (and the views of legal counsel), but it often includes in Japan and other jurisdictions:

- current and future pricing, costs of production, and profitability data;
- marketing and long term strategic plans;
- customer specific pricing and discounts, including margin information (though providing aggregate customer information is usually permissible);
- customer lists (including size and share);
- purchased goods and services costs, and supplier data;
- non-public capital expenditure or product development plans, particularly products that are close to launching;
- information on product innovation or R&D plans; and
- proprietary technology and manufacturing data.

A broad definition of competitively sensitive information benefits the seller as it will restrict the purchaser's full use and access rights to this information prior to the closing. Given the lack of Japanese regulatory guidance on what constitutes competitively sensitive information, a purchaser should have experienced legal counsel negotiate its scope and breadth to avoid unnecessarily hand-cuffing a purchaser's due diligence team by having swaths of information segregated into a "Clean Room" that will be subject to usage and disclosure limitations.

Scope of clean team members. A person should not be a member of the clean team if he/she could use competitively sensitive information for the benefit of the purchaser's day-to-day business operations (either before the transaction closes or after the transaction is abandoned), or thwart competition. For example, a clean team member should not have (and should not reasonably be expected to have in the near future) responsibilities with respect to strategic planning, sales/pricing terms, marketing strategy, procurement, research & development or other matters that could allow such person to use competitively sensitive information in an anti-competitive manner.

Consequences of forming a clean team structure. Using a clean team structure imposes a panoply of bureaucracy and expenses on a purchaser in most jurisdictions, such as requiring it to:

- negotiate a clean team agreement;
- evaluate who should be clean team versus non-clean team members;
- prepare separate due diligence reports for clean/non-clean team members;

- refrain from sharing information with non-clean team members; and
- prevent clean team members from engaging in activities competitive with the target company for a period of time if the transaction does not close.

A purchaser faced with a seller's request to follow a clean team structure should not assume that its adoption is automatically required. The time, cost and consequences of forming a clean team are high for a purchaser and should not be underestimated. Instead, use of a clean team structure should be considered the exception, not the rule. Greater caution in exchanging information is advisable through a clean team structure if: (a) there is substantial competitive overlap between the purchaser and the target company, (b) the seller anticipates exchanging a significant volume of competitively sensitive information (and not just a few files), and (c) the transaction raises potential antitrust issues.

A seller also will incur administrative hurdles under a clean team structure because it will need to prepare and negotiate a clean team agreement, select and place competitively sensitive information in a "Clean Room," and ensure that such information is not disclosed in management presentations or Q&A materials that are available to the purchaser's non-clean team members.

Not using a clean team structure does not mean that a target company's confidential information will not be protected. As an alternative to a clean team agreement, the parties can rely on the provisions of a confidentiality agreement (which is normally executed at the commencement of an M&A transaction) that (i) limits the disclosure of confidential information to persons who "need to know" such information, (ii) restricts the use of confidential information solely for evaluating, negotiating and consummating the proposed M&A transaction in a manner agreed with the seller, and (iii) requires the return or destruction of all confidential information in the event the transaction does not sign or fails to close. A confidentiality agreement is normally broader in scope than a clean team agreement, which leads to a greater likelihood of capturing breaches by a purchaser.

Conclusion

From a deal execution perspective, if there is a dearth of laws and rulings that directly regulate the contours of gun-jumping and clean team formation, it behooves a purchaser not to immediately acquiesce to a seller's request for minimal interim operating restrictive covenants in M&A documentation or strict information sharing guidelines. A purchaser should consult with legal counsel to strike the appropriate balance between its legitimate business interests to preserve the value of the target company and obtain target company information to assess the viability of the acquisition, versus actions that might restrict the target company's rightful ability to compete in the ordinary course prior to the closing. The foregoing analysis becomes more complex if the target company has global operations since the competition laws of more than one country could apply to the proposed M&A transaction.

It is important to involve competition counsel early in a transaction because an antitrust violation normally cannot be cured without regulatory consequences, and the risks of an antitrust violation can remain even years after the closing of the deal.

Annex
Antitrust Regulatory Filing Requirements

	Share Acquisitions	Mergers	Joint Share Transfers	Business Transfers/Asset Purchases	Corporate Splits/De-mergers
Conditions	Purchaser's "Japan sales"[1] exceed **JPY 20 billion** over its most recently completed fiscal year;[2] Target company's Japan sales[1] exceed **JPY 5 billion** over its most recently completed fiscal year; and[3] Voting rights held by purchaser in the target company after the transaction **exceed 20% or 50%**[4]	Japan sales[1] of a party exceed **JPY 20 billion** over its most recently completed fiscal year; and[2] Japan sales[1] of the other party exceed **JPY 5 billion** over its most recently completed fiscal year.[2]	Japan sales[1] of a party exceed **JPY 20 billion** over its most recently completed fiscal year; and[2] Japan sales[1] of the other party exceed **JPY 5 billion** over its most recently completed fiscal year.[2]	Purchaser's Japan sales[1] exceed **JPY 20 billion** over its most recently completed fiscal year; and[2] Japan sales[1] generated by the target business/ transferred assets exceed **JPY 3 billion** over the most recently completed fiscal year.	*Joint incorporation-type company splits*[5] Notification is required if any of the following conditions are satisfied: (a) where each party will split all of its business, Japan sales[1] of one party exceeds **JPY 20 billion** and Japan sales[1] of the other party exceeds **JPY 5 billion**; (b) where only one party will split all its business, Japan sales[1] of the party splitting all of its business exceeds **JPY 20 billion** and Japan sales[1] of the other party splitting a *part* of its business exceeds **JPY 3 billion**; (c) where only one party will split all its business, Japan sales[1] of the party splitting all of its business exceeds **JPY 5 billion** and Japan sales[1] of the other party splitting a *part* of its business exceeds **JPY 10 billion**; or

	Share Acquisitions	Mergers	Joint Share Transfers	Business Transfers/Asset Purchases	Corporate Splits/De-mergers
					(d) where each party will split a *part* of its business, Japan sales[1] of one party exceeds **JPY 10 billion** and Japan sales[1] of the other party exceeds **JPY 3 billion** *Absorption-type company splits* Notification is required if any of the following conditions are satisfied: (a) where each party will split all of its business, Japan sales[1] of one party exceeds **JPY 20 billion** and Japan sales[1] of the other party exceeds **JPY 5 billion**; (b) where a party will split all of its business, Japan sales[1] of the splitting party exceeds **JPY 5 billion** and Japan sales[1] of the party absorbing the split business exceeds **JPY 20 billion**; (c) where a party will split a *part* of its business, Japan sales[1] of the splitting party exceeds **JPY 10 billion** and Japan sales[1] of the other party absorbing the split business exceeds **JPY 5 billion**; or

	Share Acquisitions	**Mergers**	**Joint Share Transfers**	**Business Transfers/Asset Purchases**	**Corporate Splits/De-mergers**
					(d) where a party will split a *part* of its business, Japan sales[1] of the splitting party exceeds **JPY 3 billion** and Japan sales[1] of the party absorbing the split business exceeds **JPY 20 billion**
Filing Party	Purchaser	Jointly by the merging companies	Jointly by the merging companies	Purchaser	Jointly by purchaser and seller

[1] Japan sales consist of (i) sales of goods and services to individual domestic consumers (i.e., excluding business entities), (ii) sales of goods and services supplied to business entities (except where it is known that the goods will be shipped outside of Japan at the time of entering into the sales contract without any changes made to the goods), and (iii) sales of goods and services supplied outside of Japan to business entities where it is known that the goods will be shipped to Japan at the time of entering into the sales contract without any changes made to the goods.

[2] Japan sales are calculated on a group basis, which means it includes the Japan sales of the subject entity, its subsidiaries, its ultimate parent company, and the subsidiaries of the ultimate parent company. A parent-subsidiary relationship is recognized when a company has control over another company's business or financial decision-making, taking into account such factors as majority ownership, or a minimum ownership of 40% of the voting rights in the company plus majority board representation, contractual veto rights, and the extension of loans.

[3] Includes the Japan sales of the target company and its subsidiaries.

[4] Reaching the percentage threshold in an initial acquisition does not mean the threshold automatically will be satisfied in an add-on transaction. For example, a share acquisition that increases shareholding from 19% to 21% satisfies this condition; however, a share acquisition that increases shareholding from 21% to 49% will not satisfy this condition. A shareholder who makes a filing and subsequently falls below the 20% ownership threshold will be required to make a fresh filing if it subsequently acquires more than 20% of the voting rights in the target company (and the other Japan sales conditions are satisfied).

[5] For a discussion of the differences between an incorporation-type company split and an absorption-type company split, *see* Stephen D. Bohrer and Tatsuya Tanigawa, "Everything You Always Wanted to Know About Corporate Splits in Japan (But Were Afraid to Ask)," *The M&A Lawyer*, 2016, 20(7), at 17-27.