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Foreign Firm Access to Japanese Distribution Systems: Trends in Japanese Antitrust Enforcement

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FOREIGN FIRM ACCESS TO JAPANESE DISTRIBUTION SYSTEMS: TRENDS IN JAPANESE ANTITRUST ENFORCEMENT

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Abstract: The Japanese substantive competition law is, in theory, very well equipped to prevent anticompetitive behavior that restricts competition. In reality, the JFTC has been weak in enforcing the law. The JFTC has been particularly weak in two areas, boycotts and non-price vertical restraints, making market entry difficult for foreign firms. In response to criticisms of weakness, the JFTC released the 1991 Guideline that states that boycotts may constitute an unreasonable restraint of trade and be subject to administrative surcharges and possible criminal sanctions. Despite the strengthening of the law against boycotts, no cases have been brought. Furthermore, the JFTC has yet to make public the critical factors necessary to determine a finding of non-price vertical restraints. The author asserts that the JFTC will have to bring increasing enforcement in these two areas to create greater ease of foreign market entry.

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I. INTRODUCTION

A fundamental tenet of a "competitive market" is the freedom of new firms and noncompetitive firms to enter and to exit a market. In accordance

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with this first tenet of competition, the Japan Antimonopoly Law ("AML")[1] has the substantive legal power to protect competition. Yet, Japan's historical lack of emphasis on competition has allowed firms in the Japanese market to benefit from government regulation and high market concentrations that impede the entry of new firms.[2] As the Japanese Government increasingly liberalizes these regulations, the anticompetitive aspects of the Japanese market structure deserve increased scrutiny.

Free market entry has implications for Japanese trade policy. In 1990, the Bush and the Kaifu Administrations concluded the Structural Impediments Initiative ("SII"),[3] a U.S.-Japan bilateral commitment to reduce Japanese structural trade barriers. In an effort to secure greater market entry for foreign firms in the Japanese market, the United States pressured the Japanese Fair Trade Commission ("JFTC") to strengthen the AML. As a result of the SII and internal pressure to adjust to a consumer oriented society, the JFTC, among other measures, released a guideline in 1991 entitled the Antimonopoly Act Guidelines Concerning Distribution Systems and Business Practices (Guidelines).[4] This administrative guideline clarifies that group boycotts may constitute an unreasonable restraint of trade, and thus are subject to surcharges and possible criminal sanctions.

This article focuses attention on the methods and efforts to improve freedom of entry into the Japanese market by increasing new entrant access, both foreign and domestic, to the distribution system. The highly oligopolistic nature of the Japanese distribution system warrants careful consideration from a competition policy perspective; the structure has prevented foreign firms from reaching the Japanese consumer through boycotts and non-price vertical restraint market foreclosure.

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1 Shiteki dokusen no kinshi oyobi kōsei torihiki no kakuho ni kansuru hōritsu (Law Concerning the Prohibition of Private Monopoly and the Maintenance of Fair Trade), Law No. 54 of 1947 [hereinafter Antimonopoly Law].

2 *See generally* ED LINCOLN, JAPAN'S UNEQUAL TRADE (1991).

3 SII was a Bush Administration initiative to define, in concert with Japan, structural barriers that restrain trade. The United States pointed to *keiretsu* and the high cost of land as examples of structural barriers to import access. Japan pointed out the U.S. Federal deficit as being a structural problem. *See, e.g.,* Andrew Pollack, *A Tentative Japan is Giving Trust-Busting a Try,* N.Y. TIMES, July 29, 1992, at D1; Teresa Watanabe, *Aftermath of the Bush Trip,* L.A. TIMES, Jan. 10, 1992, at D1.

4 Ryūtsū torihiki kankō ni kansuru dokusen kinshi hō jō no shishin [Antimonopoly Act Guidelines Concerning Distribution Systems and Business Practices] (July 11, 1991).

II. THE PROBLEM: BOYCOTTS AND NON-PRICE VERTICAL RESTRAINTS

The organization of Japanese firms into cohesive groups, called *keiretsu*, is criticized as anticompetitive by foreign firms attempting to enter the Japanese market. The *keiretsu* structure may facilitate two different practices that limit competition from foreign firms: boycotts and non-price vertical restraints.

In simple terms, a boycott is any concerted agreement among firms not to deal with a specified firm. Due to the highly integrated nature of *keiretsu* distribution systems with member firms, a decision not to deal with competing foreign firms' products can prevent the foreign firm from entering the market.

Standards to determine the illegality of market entry problems concerning non-price vertical restraints is not as clear-cut as boycotts. *Keiretsu* distribution systems are characterized by many non-price vertical restraints such as long term relationships, tie-ins, territorial restrictions and exclusive contractual agreements. A non-price vertical restraint is any type of restriction unrelated to price which is placed on one firm by another. These restrictions between firms can directly affect market access for a potential entrant.

The evaluation of which non-price vertical restraints are actionable under the AML is entirely dependent upon factors such as market structure, inter-brand competition, and market power. A *keiretsu* group's use of non-price vertical restraints is in principle not an infraction of the Japanese Antimonopoly Law. For example, a Japanese distributor's choice not to deal with a product, foreign or domestic, may be a valid business decision based upon freedom of contract. However, if several *keiretsu* structures create an oligopolistic market structure, a *keiretsu* distribution system's refusal to deal may have anticompetitive effects that can illegally prevent foreign firm market entrance. To properly understand the JFTC's method of analyzing boycotts and non-price vertical restraints, a brief explanation of the structure of the Japanese AML is necessary.

A. *Japan's Antimonopoly Law*

The body of the AML that regulates anticompetitive conduct is applied to three main categories: 1) private monopolization; 2) unreasonable restraint of trade; and 3) unfair trade practices. The first two pillars, private monopolization and unreasonable restraint of trade, deal solely with conduct that "substantially restrains trade, contrary to the public interest in any field of trade,"[5] while the third pillar deals with unfair trade practices which "tend to impede fair competition."[6] The differing thresholds between "substantial restraint" and "tends to impede" are a major factor in the manner by which the AML is enforced.

1. *The First Two Pillars*

Article 2(5) concerns "Private Monopolization." Under article 2(5) of the AML "private monopolization" is defined as "any entrepreneur, individually, or by combination or conspiracy with other entrepreneurs, or in any other manner, [who] excludes or controls the business activities of other entrepreneurs, thereby restraining . . . substantially competition in any particular field of trade."[7] The term "substantial" in this provision refers to the ability of any single, or group of, entrepreneur(s) to control a market by influencing price, quality, volume of product flow, or other various business conditions.

Similarly, under the second pillar, article 2(6) defines, among other things, cartels. Under article 2(6), "unreasonable restraint of trade" occurs when "any entrepreneur, by contract or agreement or any other concerted actions, . . . substantially [restrains] competition in any particular field of trade."[8] It is important to note that both article 2(5) concerning monopolization and article 2(6) concerning cartels must meet the threshold of "substantial restraint" to be defined and violate article 3 of the AML.[9]

2. *The Third Pillar*

Unlike the "substantial restraint of trade" threshold for article 3 infractions, the threshold for finding "unfair trade practices" is comparatively lower, requiring only a "tendency to impede competition." "Tends to impede" is defined as the *possibility* that conduct may impede fair competition. Therefore, to find an infraction of the unfair trade practices provision of the AML, no proof of "substantial restraint" is necessary. If the conduct

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5 Antimonopoly Law, *supra* note 1, arts. 2(5), 2(6).
6 *Id.* art. 2(9) (defining unfair trade practices).
7 *Id.* art. 2(5).
8 *Id.* art. 2(6).
9 *Id.* art. 3 (prohibiting private monopolization and substantial restraint of trade).

in question has the "tendency" to impede, it can be challenged as unfair. Academic interpretations of the "tendency" threshold used in the unfair trade practices pillar explain that it is a precautionary measure to prevent business activity which aids in the concentration of economic power, which can be the first step to creating a private monopoly. Under the "tendency" standard, the primacy of protection of market entry is underscored by the JFTC Antimonopoly Law Research Group Report[10] findings. In 1982, these findings announced that conduct which "tends to impede fair competition" includes actions resulting in restriction of fair competition, as evidenced by the following: 1) a tendency to obstruct free competition; 2) methods of competition that are unfair; and 3) market fundamentals are not maintained.[11] With the JFTC "tendency" doctrine in mind, this article will now examine the Distribution Guidelines of 1991, the changes made concerning the enforcement of boycotts, and how in theory this should help foreign firm entry into the Japanese market. After examining boycotts, this article will then examine the case law concerning boycotts and non-price vertical restraints that have implications for market entry.

B. *Guidelines and a New Treatment of Boycotts*

Pillar three of the unfair trade practices section has two main components. First, all unfair trade practices are defined under article 2(9)[12] and classified under Notification 15 of 1982.[13] Second, conduct that is defined as illegal is prohibited by both article 19[14] and, if there is "substantial

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[10] *See* JFTC ANTIMONOPOLY LAW RESEARCH GROUP, THE FUNDAMENTAL PERSPECTIVE WITH RESPECT TO UNFAIR TRADE PRACTICES (July 8, 1982).

[11] *Id.*

[12] Under art. 2(9) of the Antimonopoly Law, the term "unfair trade practices" includes all of the following:

> (i) Unjustly discriminating against other entrepreneurs;
> (ii) Dealing at unjust prices;
> (iii) Unjustly inducing or coercing customers of a competitor to deal with oneself;
> (iv) Dealing with another party on such terms as will restrict unjustly the business activities of the said party;
> (v) Abuse of dominant position in the transaction; and
> (vi) Unreasonable interference in the internal matters of competitors.

Antimonopoly Law, *supra* note 1, art. 2(9).

[13] Notification 15 designates sixteen unfair business practices pursuant to the six basic categories in 2(9). In general, they are concerned with: (1) Concerted Refusal to Deal, (10) Tie-in sales, (11) Dealing on Exclusive Terms (13) Dealing on Restrictive Terms and (14) Abuse of Dominant Bargaining Position.

[14] Article 19 states that "No entrepreneur shall employ unfair trade practices."

restraint," article 3[15] respectively. As previously stated, a concerted agreement between manufacturers and retailers/distributors to refuse to deal with a competing product is a boycott. Prior to the 1991 Guidelines, such a boycott was enforced under article 19, and thus subject to only cease and desist orders. It was not enforced as an "unreasonable restraint of trade," and therefore not subject to the surcharges and possible criminal charges, under the more strict standard of article 3.

Following the SII negotiations, the JFTC Guidelines changed the administrative treatment of boycotts. The change made it possible to bring criminal action and surcharges against a boycott under the "unreasonable restraint of trade" provision of article 3 if it was determined that the boycott was significant. An example of such conduct would include a situation in which manufacturers and retailer/distributors agree not to handle imported goods of a significant entrepreneur that compete with those of the manufacturer. Since the issuance of the Guidelines, there have been no article 3 cases brought against Japanese firms boycotting foreign firms. (The following case is an example of a boycott by a Japanese firm which was found to be an "unreasonable restraint of trade.")

1. Ishizuka *Case*[16]

The *Ishizuka* case concerns a violation of article 8(1)(5) as an unfair trade practice. This provision prohibits trade associations from "causing entrepreneurs to employ such acts as to constitute unfair trade practice."[17] In summary, Ishizuka Glass Company, in concert with other secondary manufacturers of replacement automobile glass, entered into an agreement with the Tokyo Metropolitan Automobile Parts Association (Tokyo-to Jidōsha Bukai) and parts wholesalers to boycott any manufacturer or wholesaler that sold products at a discount price.

To execute the price stabilization and restraint of competition, the Association entered into a tri-lateral agreement with the secondary manufacturers and wholesaling agents. According to the agreement, secondary manufacturers and wholesalers decided upon the price at which to sell their

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[15] Article 3 states that "No entrepreneur shall effect private monopolization or any unreasonable restraint of trade." Antimonopoly Law, *supra* note 1, art. 3

[16] Judgment of Dec. 11, 1967 (Ishizuka), FTC [decision], 14 Shinketsushū 14.

[17] Antimonopoly Law, *supra* note 1, ch. 3, (concerning Trade Associations). It is important to note that trade association violations correspond to article 19 violations under the "Unfair Trade Practices" pillar of the AML.

secondary manufactured goods. Additionally, the tri-lateral group decided not to deal with secondary manufacturers and wholesalers that traded secondary manufactured goods through non-Association members. The use of the threat of a boycott to maintain the price fixing agreement was found to be an unreasonable dealing restriction, and in violation of article 3. Furthermore, the act of restricting wholesalers to deal only with Association members falls under article 8(1)(5), which prohibits trade associations from engaging ". . . in any acts which . . . [cause] entrepreneurs to employ such acts as constitute unfair trade practices."[18]

C. Non-price Vertical Restraint Case Law

Non-price vertical restraints is another area of law related to market entry issues. Contrary to the lack of article 3 boycott case law, there is significant case law concerning non-price vertical restraint as unfair trade practices under Notification 11, which restricts undue exclusive dealing, and under Notification 13, which restricts undue restrictive dealing. In examining the relevant case law, it becomes apparent that the JFTC has only brought action against non-price vertical restraints executed by firms that occupy extraordinarily high market shares, making determination of anti-competitve effect relatively easy. In the interest of increasing market entry, the next step for the JFTC is to increasingly scrutinize the non-price vertical restraints of firms that hold lower market shares.

1. Fuji X-ray[19]

The *Fuji X-ray* case concerns the infraction of competition law in the form of non-price vertical restriction initiated by Fuji Films' 100% owned subsidiary, Fuji X-ray. Fuji X-ray, occupying 53% of the medical X-ray film market, was accused of restrictive dealing and binding restrictions including territorial restriction of sales. Fuji X-ray controlled the resale prices of its distributor, and prevented the distributor from competing in other distributors' territory. Fuji X-ray, by forming a territorial restriction, essentially lessened competition among the distributors. Through its closed-territory action, Fuji Film successfully controlled intra-brand com-

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[18] *Id.* ch. 3, art. 8(1)(5).

[19] Judgment of May 11, 1981 (Fuji X-ray), FTC [decision], 28 Shinketsushū 39.

petition in the concerned market, and also limited inter-brand competition.[20] Fuji X-ray's high market concentration makes any effort to restrict, whether inter- or intra-brand competition, a tendency to impede competition. The JFTC ruled that the Fuji X-ray activity constituted a violation as an Unfair Trade Practice under article 19, specified under Notification 13,[21] and required Fuji X-ray to cease and desist the practices.

2. Zenhanren[22]

In the *Zenhanren* case, Zenhanren (Japanese Agricultural Cooperative) forced almost all firms to use new linen bags to pack and store rice while concurrently controlling the linen bag distribution system. Furthermore, Zenhanren forced linen bag manufacturers to supply linen bags to the members of its Cooperative before supplying to other competitors. Zenhanren thus prevented the linen bag manufacturers from dealing with other companies before completing the delivery of the contracted amount of bags to Cooperative firms. The Cooperative did not allow the bag manufacturers to deal directly with the members, but forced all products to move through Zenhanren. Zenhanren was found to be "dealing with exclusive conditions" under Notification 11. Looking at Zenhanren's actions from the perspective of "exclusion of competitors . . . it [Zenhanren] excluded competitors that deal in the distribution of new linen bags, maintaining its own monopolistic position." The result was a cease and desist order issued by the JFTC.

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[20] HASEGAWA, JŪHŌ HANREI KAISETSU (1981).

[21] The original ruling of the Fuji X-ray case was prior to the 1982 Fair Trade Commission Notification No. 15, and was originally found in violation of article 8.

[22] Judgment of Dec. 4, 1963 (Zenhanren), FTC [decision], 12 Shinketsushū 39. In both the Zenhanren (Japan Agricultural Sales Cooperative) and the Zenkoku Nogyo Rengo (Japan Farming Produce Association) case, the defendants were cooperatives exempted from the AML pillar two application by article 24. However, in the provision of article 24, it is clearly stated that even cooperatives are not exempted from scrutiny under unfair dealing methods. The exemption applies as long as the following requirements regarding the cooperative are met: 1) its purpose shall be the mutual aid among small scale entrepreneurs or consumers; 2) it shall be voluntarily formed; 3) each member shall posses equal voting rights; and 4) if distribution of profits among members is contemplated, the limits shall be stipulated in law or an order, or in the article of association.

3. Zenkoku Nogyo Rengokai[23]

The next case involves Zenkoku Nogyo Rengokai (The Japanese Agricultural Produce Cooperative - Zenno). In this case, a manufacturer of corrugated cardboard bought paper from Zenno and then sold the finished product directly to customers. Zenno, with a sixty percent share of all sales of corrugated cardboard, stopped supplying the manufacturer to prevent low-priced sales by a non-Zenno route. Furthermore, Zenno requested that its member entrepreneurs refuse to purchase products from the parent company of this newly established cardboard manufacturing firm. Given the effect of excluding competitors, Zenno's action is clearly illegal for two reasons: 1) its purpose is to exclude new entry by potentially competitive companies and 2) its improper use of the power over the other firms in making them not deal with the new market entrant. These two factors taken together have the same effect of excluding competitors as concerted refusals to deal.[24] In summary, the JFTC administered a cease and desist order against Zenno because Zenno had forced a new entrant in the corrugated cardboard box market to exit the market as a result of its "undue restrictive dealing."

The above non-price vertical restraint cases are examples of enforcement by the JFTC of the AML against conduct that forecloses a market and prevents new market entry. In each case, the JFTC considered the act of excluding a competitor from the market as a serious factor in deciding whether the non-price vertical restraint constituted a violation. Yet this consideration was overshadowed in each case by the defendants extraordinary dominant market position. Furthermore, most of the cases brought by the JFTC concern firms that are expelled from a market through boycott and restrictive dealing. Although "market foreclosure" and "entry barrier" theory are related, they do not directly address the market entry needs of foreign firms not yet in the Japanese market.

III. CONCLUSION

Foreign firms currently face barriers to market entry in Japan. One impediment to increasing market entry is the ambiguity of the JFTC non-price vertical restraint analysis. Unlike the relatively clear articulation of

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23 Judgment of Feb. 20, 1990 (Zenkoku Nōgyō Rengokai), FTC [decision], 36 Shinketsushū 53.
24 SANEKATA, 4 HANREI HYAKUSEN.

the "rule of reason" in the U.S., the JFTC has yet to articulate the leading factors that are used in determining what type of restraint in what kind of market condition is "pro" or "anti" competitive. Obviously, enforcement of non-price vertical restraint law is a process of balancing "pro" and "anti" competitive effects, but the JFTC has yet to clarify what it perceives as the leading factors and their relative weights. The JFTC should clarify these factors. Furthermore, priority should be given to market foreclosure that may tend to impede new entry. The result would place a heavy burden of proof on the pro-competitive aspects for any vertical restraint that might restrain free competition.

The JFTC should be more receptive to the benefits of potential competition provided by foreign firms. Along these lines, the JFTC should actively enforce against conduct that impedes foreign access to the Japanese market and that is considered a "tendency to impede competition." Similarly, the JFTC has issued the 1991 Guidelines which announced that the JFTC will aggressively pursue conduct that boycotts foreign firms under article 3. The JFTC, however, has yet to act in accordance with this administrative change.

One of the most important points of the antimonopoly regulation of Japan's distribution system is to prevent barriers to market entry. In the present state of enforcement, the JFTC falls short of achieving this goal.