



**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

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**ROUNDTABLE ON FAILING FIRM DEFENCE**

**-- Note by the Delegation of Japan --**

*This note is submitted by the delegation of Japan to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 21 - 22 October 2009.*

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## **FAILING FIRM DEFENCE**

**-- Note by Japan --**

### **1. The Issue of the Failing Firm Defence under the Antimonopoly Act**

1. Under the Antimonopoly Act (AMA) in Japan, the condition that “the effect of a business combination may be substantially to restrain competition” should be satisfied to prohibit a business combination.

2. Although there is no provision in the AMA that gives the interpretation of “the effect may be substantially to restrain competition,” the Japan Fair Trade Commission (JFTC) sets out its framework of determining the effect of what kind of business combination may be substantially to restrain competition by formulating and publishing “the Guidelines to Application of the Antimonopoly Act Concerning Review of Business Combination” (formulated in 2004 and most recently revised in 2007; hereinafter referred to as “the M&A Guidelines”).

3. More specifically, the M&A Guidelines categorize the types of business combinations into (a) horizontal and (b) vertical and conglomerate business combinations, and then provide the cases when the effect of a business combination may be substantially to restrain competition by unilateral conduct or coordinated conduct for each type of business combination. In addition, the M&A Guidelines show determining factors such as the position of the company group (“the company group” refers to all companies that would form, maintain and strengthen the joint relationships by the business combination) and the competitive situation, import, entry, competitive pressure from related markets, competitive pressure from users, etc. and describe each of the determining factors. The M&A Guidelines further indicate that these determining factors should be given comprehensive consideration to decide whether the effect of a business combination may be substantially to restrain competition.

4. The M&A Guidelines consider the poor business results, etc. of the company group as one of the determining factors for either type of business combination. This means that the so-called failing firm defence is regarded as one of the determining factors to consider whether the effect of a business combination may be substantially to restrain competition, like other factors such as import, entry, etc.

### **2. How the failing firm defence is described in the M&A Guidelines**

5. In the M&A Guidelines, the poor business results, etc. of the company group are explained as follows: (NOTE: The following description is about the substantial restraint of competition by unilateral conduct in the case of horizontal business combinations, but the same applies to other types.)

“Financial Conditions of the Company Group”

A. Poor Results, etc.

To evaluate the business ability of the company group, the financial conditions, such as whether the results of part of the company group or the business section in question are poor or not, are also taken into consideration.

Meanwhile, the possibility that the effect of the business combination may be substantially to restrain competition in a particular field of trade is usually thought to be small if a party to the combination has excess debt or is unable to obtain finance for working capital and it is likely to go bankrupt and exit the market in the near future, and 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.

B. When the Possibility that the Business Combination May Be Substantially to Restrain Competition Is Usually Thought to Be Small

Whether or not a business combination has the potential to substantially restrain competition in a particular field of trade is determined by taking into comprehensive consideration all relevant determining factors in each of the specific cases. In the following cases, however, the possibility that the effect of a horizontal business combination may be substantially to restrain competition in a particular field of trade by unilateral conducts is usually thought to be small.

(a) A party to the combination 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.

(b) The performance of a business department of a party to the combination is extremely poor and it is obvious that the party would be highly likely to exit the market in the near future without the business combination. Moreover, it is difficult to find any business operator that can rescue the business department with a combination that would have less impact on competition than the business operator that is the other party to the combination.

6. Under the M&A Guidelines before the revision in 2007, it was regarded that the market share of the company group after the business combination needs to be 50% or less for the poor business results, etc. to be acknowledged for consideration in the review of business combinations (hereinafter referred to as “the M&A review”). On the other hand, after their revision, by eliminating the upper limit of the market share, the M&A Guidelines articulated that there is a possibility that the poor business results, etc. will be accredited for consideration in the M&A review even if the market share of the company group is more than 50%.

7. The M&A Guidelines also provide examples to show the strong likelihood that the company will go bankrupt and exit the market in the near future, such as when a party to the combination has excess debt or is unable to obtain finance for working capital.

8. In addition, as is clear from the excerpt from the M&A Guidelines shown above, (not only the poor business results, etc. of a company as a whole, but) poor business results, etc. of only a business department of a party to the combination can be taken into consideration in the M&A review.

### **3. How the poor business results, etc. of the company group are acknowledged**

9. It is necessary to determine on a case-by-case basis whether the poor business results, etc. of the company group should be considered or not. The M&A Guidelines do not provide any explanation about what kind of facts should be considered and what kind of evidence should be the basis for such facts when the poor business results, etc. of a company group are to be acknowledged. In this regard, “Policies dealing with prior consultation regarding business combination plans” (formulated in 2002 and most recently revised in 2007, hereinafter referred to as “the Prior Consultation Guidelines”) formulated and published by the JFTC would be helpful. The JFTC receives prior consultations from the parties to business combinations regarding whether the planned business combinations may raise issues of concerns or not under the AMA. (Such kind of a prior consultation shall be hereinafter referred to as “a prior consultation.”) In reality, most of the substantial reviews of business combinations are conducted through the prior consultation process. The Prior Consultation Guidelines provide the process and the procedures of the prior consultations.

10. The Prior Consultation Guidelines present as a convenient reference to the parties to the business combinations the examples of materials voluntarily submitted by the parties for showing the basis for factors examined in the M&A review. Regarding the financial condition of the company group, the following materials are given as examples:

1. Materials showing the financial status of a company posting poor business results
2. Materials showing the status of negotiations with other companies capable of bailing out the company posting poor business results

11. This suggests that the JFTC would use these materials as evidence in certifying the poor business results, etc. of the company group.

12. Needless to say, the materials that the JFTC examines in the M&A review are not limited to those mentioned above. Other materials would include those showing the causes and processes that led to the poor business results and the reasons that it is difficult for the company to recover by itself.

### **4. Cases referring to poor business results, etc. of the company group**

13. Although there are cases in which the JFTC considered the poor business results, etc. of a company as a whole or a specific business department as a determining factor in the M&A reviews, the number of such cases is not large. In this contribution paper, the following cases are chosen from the cases<sup>1</sup> which the JFTC published the results of its review in the past.

#### **4.1 *Merger of Iyo Bank Ltd. and Toho Sogo Bank Ltd.***

14. In this case, Iyo Bank and Toho Sogo Bank, which are both regional banks with head offices in Ehime Prefecture, planned to merge on 1 April 1991. It was expected that the post-merger bank would have high market shares in deposits and loans in the whole Ehime Prefecture as well as certain parts of the prefecture. However, in addition to the fact that the increments of the market shares were not large as a

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<sup>1</sup> The JFTC compiles and publishes the results of the main mergers and acquisitions cases every fiscal year.

whole, the purpose of the merger was to avoid the bankruptcy of the Toho Sogo Bank and it would be very difficult to find any other appropriate merger partner than Iyo Bank. Taking these points into consideration, the JFTC held that the merger would not be substantially to restrain competition in any particular field of trade.

#### **4.2 *Hokuyo Bank's acquisition of the business of Hokkaido Takushoku Bank***

15. In 1998, Hokkaido Takushoku Bank, which was one of the nation's largest city banks, gave up rebuilding itself because it became almost unable to raise funds from the short-term financial market, and planned to transfer its whole business in the Hokkaido area where it mainly operates, to Hokuyo Bank.

16. The combined market shares after the business combination in deposits and loans were expected to become large in the whole Hokkaido area as well as in certain parts of Hokkaido. However, the JFTC concluded that the acquisition would not be substantially to restrain competition in either particular field of trade because, in addition to the existence of major competitors, Hokkaido Takushoku Bank had given up rebuilding itself and decided to transfer its business due to difficulties in raising funds.