# GUIDELINES CONCERNING UNJUST LOW PRICE SALES UNDER THE ANTIMONOPOLY ACT

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Fair Trade Commission

## 1. Introduction

Unjust low price sales are banned by the Act on Prohibition of Private Monopolization and Maintenance of Fair Trade (Act No. 54 of 1947; hereinafter referred to as the "Antimonopoly Act") as a form of unfair trade practices. The provisions on unjust low price sales have been revised as follows by Act No. 51 of 2009 and the revision of the Designation of Unfair Trade Practices (Fair Trade Commission Public Notice No. 15 of 1982):

(1) Article 2, paragraph (9), item (iii) of the Antimonopoly Act
Without justifiable grounds, supplying goods or services continuously for a consideration which is excessively below the costs required for the supply, thereby tending to cause difficulties to the business activities of other entrepreneurs

(2) Paragraph (6) of the Designation of Unfair Trade Practices
In addition to any act falling under the provisions of Article 2, paragraph (9), item (iii) of the Antimonopoly Act, unjustly supplying goods or services for a low consideration, thereby tending to cause difficulties to the business activities of other entrepreneurs

It has been decided that, among these acts, any entrepreneur who engages in the unjust low price sales prescribed in Article 2, paragraph (9), item (iii) of the Antimonopoly Act (hereinafter referred to as "statutory unjust low price sales") and who satisfies certain requirements, such as having received an administrative disposition for engaging in statutory unjust low price sales within the past ten years, shall be ordered to pay a surcharge (Note 1). Therefore, from the viewpoint of increasing the transparency of the operation of laws and enhancing entrepreneurs' foreseeability with regard to unjust low price sales, the Fair Trade Commission has decided to partially revise the Guidelines Concerning Unjust Low Price Sales under the Antimonopoly Act (November 20, 1984; General Secretariat, Fair Trade Commission) in order to clarify said guidelines further by focusing particularly on "a consideration which is excessively below the costs required for the supply" from among the requirements for statutory unjust low price sales.

These guidelines only indicate the matters to be taken into consideration when applying the provisions to unjust low price sales. Actual cases must, of course, be judged in light of individual circumstances.

(Note 1) Since any act that is categorized as statutory unjust low price sales can be sufficiently dealt with by applying only the provisions of Article 2, paragraph (9), item (iii) of the Antimonopoly Act, the provisions of paragraph (6) of the Designation of Unfair Trade Practices are never applied to such act.

## 2. The purposes of regulations concerning unjust low price sales

The purpose of the Antimonopoly Act is to maintain and promote fair and free competition, and to encourage entrepreneurs' efforts to provide high-quality, inexpensive goods and services (hereinafter collectively referred to as "goods") through their creative initiative. In particular, the price competition through corporate efforts essentially constitutes the core of the competition on the merits (meaning the competition by which entrepreneurs win customers by supplying high-quality and low-cost products), that competition policy aims to maintain and promote. In this sense, low prices in themselves are not immediately considered to be improper, as a matter of course, but neither are they always considered to be proper. There is no problem in providing goods at a low price that has been achieved through an enterprise's efficient operations, but if an enterprise tries to acquire customers by offering a low price that totally disregards profitability, it is possible that such behavior runs counter to the purposes of the Antimonopoly Act and, if so, needs to be regulated. This is because an act of winning away the customers of a competitor by pricing, without justifiable grounds, goods below costs — setting such a low price that the supply of the goods cannot be continued unless the losses thereby incurred were compensated for by profits from the supply of other goods, or by other sources of funds — does not reflect corporate efforts or the proper competition process, and it could tend to cause difficulties to the business activities of entrepreneurs that are just as efficient as or more efficient than the entrepreneur engaged in the unjust low price sales (hereinafter referred to as the "price cutter") and could harm the fair competition order.

## 3. Provisions of Article 2, paragraph (9), item (iii) of the Antimonopoly Act

The provisions of Article 2, paragraph (9), item (iii) of the Antimonopoly Act read as follows:

> (iii) Without justifiable grounds, supplying goods or services continuously for a consideration which is excessively below the costs required for the supply, thereby tending to cause difficulties to the business activities of other entrepreneurs

The requirements under this item are construed from the following three aspects: 1) the mode of price cutting (the price/cost relationships and continuity); 2) the tendency of causing difficulties to the business activities of other entrepreneurs; and 3) a lack of justifiable grounds for the price cutting.

(1) Mode of price cutting

A. Price/cost relationships

(A) The price/cost relationships, that is, the requirement "a consideration which is excessively below the costs required for the supply," should be construed in accordance with the purposes of regulations concerning unjust low price sales set forth in 2. above.

(B) Specifically, one of the purposes of regulations concerning unjust low price sales is to regulate price cutting that tends to cause difficulties to the business activities of entrepreneurs that are just as efficient as or more efficient than the price cutter. Even where an entrepreneur that is just as efficient as the price cutter, such as one who is capable of supplying goods at the same cost as the price cutter, exists or is considering market entry, if goods can only be supplied at such a low price that would expand losses as more goods are supplied, it would be better for such entrepreneur to decide not to enter the market or to discontinue the supply and withdraw from the market in order to avoid incurring costs from the supply. In other words, if the price cutter supplies goods at a price that is even lower than the costs of the supply, other entrepreneurs would have no choice but to supply their goods at the same price as that of the price cutter. Even if the other entrepreneurs could supply their goods at the same low price, they would be forced to decide not to enter the market or to withdraw from the market sooner or later. In this manner, the question of whether or not a certain price affects the decision regarding the continuation of business, etc. of entrepreneurs that are just as efficient as the price cutter would be analyzed by whether said price is at such a level that immediately causes losses to the price cutter himself/herself. Therefore, the "costs required for the supply" means the "costs required for the supply" by the price cutter itself, and not the general costs required for supply of the goods in the relevant industry in general or such costs required by any specific competitor that actually exists.

(C) In light of the purposes of regulations concerning unjust low price sales set forth in 2. above, entrepreneurs are not precluded from setting prices that reflect their own corporate efforts or a proper competition process. For example, even where the price of goods is lower than the "costs required for the supply," or, the total cost of sales (Note 2), if the losses pertaining to the supply of the goods are to become smaller by continuing to supply the goods, it would be rational to supply the goods at that price. From such viewpoint, an appropriate price/cost relationship would be one that can be used to determine whether or not a certain price setting obviously lacks economic rationality for the price cutter. In this respect, a price setting that would expand losses as more goods are supplied can be deemed to lack economic rationality unless there are special circumstances. Thus, it is appropriate to determine whether or not a certain price setting lacks economic rationality by comparing the costs that arise by supplying the goods that were made subject to price cutting (hereinafter referred to as the "price-cut goods") and the price of said goods (Note 3). Such approach would minimize the risk of provoking concerns among entrepreneurs that what they consider to be a remunerative price would be regarded as being illegal, and thereby negatively affecting such entrepreneurs' business activities.

(Note 2) The total cost of sales corresponds to the sum of all costs required for supplying the price-cut goods. For an ordinary manufacturing business, it is the production costs plus the selling costs and general and administrative costs, whereas for an ordinary selling business, it is the purchasing costs plus the selling costs and general and administrative costs.

The term "production costs" here does not mean the "cost of all goods manufactured for the account period" as indicated in the production cost report, which is the total costs required for manufacturing all of the goods finished through the manufacturing activities during the current period; rather, it means the total costs required for manufacturing the goods that were made subject to price cutting. Likewise, "purchasing costs" and "selling costs and general and administrative costs" refer to the total amount of costs required for the purchasing and for the selling and administration of the goods that were made subject to price cutting, respectively.

With regard to costs such as the selling costs and general and administrative costs, which are common to multiple businesses, how to allocate such costs to respective businesses becomes an issue, and generally, in corporate accounting, the entrepreneur allocates common costs to each business depending on the degree of benefit provided by the generation of the costs, pursuant to the allocation criteria that were reasonably selected by the entrepreneur in the context of the actual conditions. In such case, if the entrepreneur is deemed to use the allocation criteria that were reasonably selected in the context of the actual conditions, the total cost of sales is usually calculated by allocating the common costs based on the said allocation criteria, although there are various allocation criteria. Then, by also reasonably distributing the costs that are common to multiple goods in light of the actual conditions, the total cost of sales for the price-cut goods shall be calculated.

As for costs such as research and development costs, which are reported collectively, if the price cutter is found to be recovering the costs over a reasonable period in light of the actual conditions, the total cost of sales for the price-cut goods shall be calculated after allocating the costs over said period.

(Note 3) Whether it is economically rational is conceptually assessed based on whether a price set by the price cutter can cover the average avoidable cost (AAC), which is the average of product-specific fixed costs and variable costs that could have been avoided if the price cutter had not produced extra output. In practice, the approach shown in (D) below is applied to assess economic rationality equivalent thereto.

(D) Whether or not a certain price is excessively below the total cost of sales is calculated on a case-by-case basis from the viewpoint of whether or not the price is insufficient for the entrepreneur to recover the costs incurred by supplying the price-cut goods. In this calculation, the following points should be taken into consideration:

a. “The costs required for the supply” are divided into costs that would not be generated unless the price-cut goods were supplied (hereinafter referred to as "variable-featured costs") and the other costs. If an entrepreneur sets a low price that is insufficient for even recovering the variable-featured costs, losses would expand as more price-cut goods are supplied. Thus, a price that is lower than the variable-featured costs is presumed to be "a consideration which is excessively below the costs required for the supply" (however, if a price is equal to or higher than the variable-featured costs, it is not "a price which is excessively below the costs required for the supply," so the supply of goods at such a price is not regarded as statutory unjust low price sales).

b. Whether or not a cost is categorized as a variable-featured cost is assessed from the viewpoint of whether the cost increases or decreases depending on the supply quantity of the price-cut goods, and/or whether the cost is closely related to the supply of the price-cut goods.

(a) Variable expenses (the costs that proportionally increase or decrease in total amount depending on the rate of capacity utilization) are regarded as variable-featured costs. Also, costs which are not obviously deemed to be variable costs but are found to increase or decrease to a certain extent depending on the changes in the supply quantity of the price-cut goods in light of the characteristics of the costs are presumed to be variable-featured costs unless there are special circumstances (Note 4). For example, variable expenses include the materials costs that are directly used for manufacturing goods and the purchase price, whereas costs that are found to increase or decrease to a certain extent depending on changes in the supply quantity of the price-cut goods in light of the characteristics of the costs include the costs incidental to the purchase of goods, such as shipping costs and receiving inspection costs.

Furthermore, costs which are not thus presumed to be variable-featured costs in light of the characteristics of the costs but which have shown increases or decreases depending on the supply quantity during the period of the price cutting in an individual case are treated as variable-featured costs, in principle.

(Note 4) If price cutting is carried out continuously, but the period of the price cutting is relatively short and the costs would not increase or decrease by the supply of the price-cut goods during that period, such circumstance is regarded as a special circumstance.

(b) Among the expense items in corporate accounting, those that have a close relevance to the supply of the price-cut goods may be regarded or presumed to be regarded as variable-featured costs, as shown below.

(i) Production costs

Production costs are an important factor that constitutes the "cost of sales" of the goods that a manufacturer sells by price cutting. When a manufacturer engages in price cutting, production costs become an expense item that is calculated as costs that have a close relevance to the supply of the price-cut goods, and, in light of their characteristics, they are presumed to be variable-featured costs unless there are special circumstances (Note 5). Among the production costs, direct production costs (the direct materials costs, direct labor costs, and direct expenses) are regarded as variable-featured costs.

(Note 5) An example of a special circumstance is where the production costs include any expense item that obviously has no relevance to the supply of the price-cut goods (e.g., a case where depreciation costs for welfare facilities (tennis courts, a swimming pool, etc.) within the precincts of the factory manufacturing said goods are included in the production costs).

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(ii) Purchasing costs

Purchasing costs are the combined total of the purchase price (Note 6) and the costs incidental to the purchase, such as shipping costs and receiving inspection costs. When a seller engages in price cutting, purchasing costs become an expense item that is calculated as costs that have a close relevance to the supply of the price-cut goods, and, in light of their characteristics, they are presumed to be variable-featured costs unless there are special circumstances. Among the purchasing costs, the purchase price is regarded as a variable-featured cost.

(Note 6) The term "purchase price" here does not mean the officially listed purchase price of the goods; rather, it means the real purchase price which takes into account any discounts, rebates, or physical goods received by the purchaser in connection with said purchase.

(iii) Operating costs

Operating costs consist of selling costs and general and administrative costs. When an entrepreneur engages in price cutting, among the cost items included in the operating costs, warehouse costs, shipping costs, and costs for collecting open accounts receivable, which are costs required for the execution of orders of the price-cut goods, become expense items that are calculated as costs that have a close relevance to the supply of the price-cut goods, and, in light of their characteristics, they are regarded as variable-featured costs.

(c) From the viewpoint of whether certain costs are those that increase or decrease depending on changes in the supply quantity of the price-cut goods or those that have a close relevance to the supply of the price-cut goods, there are costs that are, in light of their characteristics, presumed not to be variable-featured costs unless there are special circumstances (Note 7) or are never regarded as variable-featured costs (Note 8).

(Note 7) The costs required for acquiring orders for the price-cut goods (such as advertising costs, market research costs, and entertainment costs) are presumed not to be variable-featured costs, unless there are special circumstances. Special circumstances include, for example, costs that were inevitably incurred for commencing or continuing the supply of the price-cut goods.

For example, with regard to advertising costs intensively spent before starting the sale of the price-cut goods in order to create demand for the goods, there may be cases where the supply of the price-cut goods would not have been launched right from the start without spending such costs. If there is such a circumstance as the costs being inevitably incurred for commencing or continuing the supply of the price-cut goods, such costs are regarded as costs that have a close relevance to the supply of the price-cut goods and are deemed to be variable-featured costs, being costs that would not have been generated unless the price-cut goods were supplied.

(Note 8) The personnel costs, transportation costs, and communications costs of the personnel department and the accounting department, which are headquarter functions, are, in light of the characteristics of the costs, neither costs that increase or decrease to a certain extent depending on changes in the supply quantity of the price-cut goods, nor those that have a close relevance to the supply of the price-cut goods, so they are never regarded as variable-featured costs.

B. Continuity

As mentioned in 2. above, in order for price cutting to be regarded as unjust low price sales, it needs to negatively affect the decision regarding the continuation of business, etc. of entrepreneurs that are just as efficient as the price cutter. Therefore, unjust low price sales are generally established when an entrepreneur engages in price cutting "continuously" to some extent. Accordingly, the provisions of Article 2, paragraph (9), item (iii) of the Antimonopoly Act read "supplying goods or services continuously for a consideration which is excessively below the costs required for the supply."

The term "continuously" either means that an entrepreneur engages in price cutting repeatedly over a considerable period of time, or that an entrepreneur is objectively predicted to be engaged in price cutting for such duration judging from said entrepreneur's sales policy, etc., and does not necessarily require price cutting to be carried out every day in a continuous manner. For example, even when price cutting is carried out only on specific dates, such as every weekend, there are cases where the entrepreneur can be regarded as supplying the price-cut goods continuously, depending on the purchasing behavior of consumers.

(2) "Tending to cause difficulties to the business activities of other entrepreneurs"

A. The term "other entrepreneurs" as used in the phrase "likely to cause difficulties to the business activities of other entrepreneurs" generally refers to competitors of the price cutter, but could also include non-competitors, depending on the mode of the price cutting. For example, in a case where price cutting by a wholesaler or a retailer negatively affects competition among manufacturers, etc., "other entrepreneurs" can in some cases include the manufacturers, etc. that supply the same kind of goods as the price-cut goods.

B. The phrase "tending to cause difficulties to the business activities of other entrepreneurs" does not necessarily require that price cutting makes business activities difficult in actuality, but it includes cases where a concrete possibility of the price cutting inviting such result is found based on various circumstances (Note 9). The presence or absence of such possibility is determined on a case-by-case basis, by comprehensively taking into consideration the actual status of other entrepreneurs as well as the size and type of business of the price cutter, the quantity of the price-cut goods, the duration of the price cutting, the status of advertising and publicity associated with the price-cut goods, the characteristics of the price-cut goods, and the price cutter's intention or purpose of price cutting.

(Note 9) For example, when an influential entrepreneur engages in price cutting, supplying goods at a price that is lower than the variable-featured costs, with the intention to exclude other entrepreneurs from the relevant market, and as a result, its sales quantity increases rapidly, making the price cutter the top seller in said market, such price cutting is regarded as being "tending to cause difficulties to the business activities of other entrepreneurs" even if the business activities of the other entrepreneurs are not found to be facing difficulty in actuality.

(3) Justifiable grounds

Even when the requirements set forth in (1) and (2) above are satisfied, if there are special circumstances that justify the price cutting, said price cutting is not regarded as impeding fair competition; thus it does not constitute unjust low price sales. For example, in cases where the market price of the price-cut goods declines due to a supply-and-demand imbalance or the replacement cost of the raw materials for the price-cut goods becomes lower than the acquisition cost of said raw materials, it is considered a case which has “justifiable grounds” for setting a low price according to the market conditions of the goods or the raw materials, or in the case where the price of the raw materials soars unexpectedly in a transaction for procuring the raw materials after the price of the goods is decided, and as a result, the price of the price-cut goods becomes excessively below the costs required for the supply, "justifiable grounds" are considered to exist (Note 10).

(Note 10)
If there is a need to make clearance sales of products such as perishable goods whose quality is likely to deteriorate rapidly or seasonal goods whose peak sales periods are over, "justifiable grounds" are considered to exist for setting a price lower than the variable-featured costs. The same applies when setting a reasonably low price for any damaged item, odd item, or otherwise defective item.

4. Provisions of paragraph (6) of the Designation of Unfair Trade Practices
(1) The provisions of paragraph (6) of the Designation of Unfair Trade Practices read as follows:

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| (Unjust Low Price Sales)<br>(6) In addition to any act that falls under Article 2, paragraph (9), item (iii) of the Act, unjustly supplying goods or services for a low consideration, thereby tending to cause difficulties to the business activities of other entrepreneurs |

Even in cases where price cutting does not satisfy either or both of the price/cost relationships and continuity, which are requirements for unjust low price sales, in other words, even when a price cutter supplies goods at a price equal to or higher than the variable-featured costs (but the price must be lower than the total cost of sales) or supplies goods at a price lower than the variable-featured costs one time only, said price cutting falls under the provisions of paragraph (6) of the Designation of Unfair Trade Practices and is regulated as being unjust low price sales, if the price cutting harms the fair competition order judging from the characteristics of the price-cut goods, the intension or purpose of the price cutter, the effects of the price cutting, the status of the entire market, and other factors.

(2) Whether or not price cutting is "tending to cause difficulties to the business activities of other entrepreneurs" is determined on a case-by-case basis, by comprehensively taking into consideration the matters listed in 3 (2) B. above. However, when an entrepreneur commanding a large market share carries out price cutting of a large quantity of goods continuously or when such entrepreneur intensively carries out price cutting of goods that are important for the management of other entrepreneurs, such price cutting is generally considered to negatively affect the business activities of other entrepreneurs, so even if the goods were supplied at a price equal to or higher than the

variable-featured costs, such price cutting may fall under the provisions of paragraph (6) of the Designation of Unfair Trade Practices. In making a judgment on such case, consideration shall be given to whether the price is lower than the costs that have relevance to the supply of the price-cut goods (the production costs or purchasing costs, and selling costs).

5. Other regulations related to the price cutting issue

The Antimonopoly Act has various provisions which deal with the price cutting issue, of which the main ones are described below.

(1) Discriminatory Consideration, and Discriminatory Treatment on Trade Terms, etc.

A. Discriminatory Consideration, etc. prohibited by the Antimonopoly Act

With regard to Discriminatory Consideration, Article 2, paragraph(9), item (ii) of the Antimonopoly Act provides, "Unjustly supplying goods or services continuously for a consideration which discriminates between regions or between parties, thereby tending to cause difficulties to the business activities of other entrepreneurs" (Note 11), and paragraph (3) of the Designation of Unfair Trade Practices provides, "in addition to any act falling under the provisions of Article 2, paragraph (9), item (ii) of Act on Prohibition of Private Monopolization and Maintenance of Fair Trade, unjustly supplying or accepting goods or services for a consideration which discriminates between regions or between parties." It should be noted that Article 2, paragraph (9), item (ii) of the Antimonopoly Act applies only to an act for supplying goods, and not to an act for accepting goods.

With regard to Discriminatory Treatment of Trade Terms, etc., paragraph (4) of the Designation of Unfair Trade Practices provides, "unjustly affording favorable or unfavorable treatment to a certain entrepreneur in regard to the terms or execution of a trade."

(Note 11) Any entrepreneur who engages in the Discriminatory Consideration prescribed in Article 2 (9) (2) of the Antimonopoly Act and who satisfies certain requirements, such as having received an administrative disposition for engaging in the Discriminatory Consideration prescribed in said item within the past ten years, shall be ordered to pay a surcharge.

Since any act that is categorized as the Discriminatory Consideration prescribed in Article 2 (9) (2) of the Antimonopoly Act can be sufficiently dealt with by applying only the provisions of said item, the provisions of paragraph (3) of the Designation of Unfair

Trade Practices are never applied to such act.

B. Basic viewpoint of regulations on the Discriminatory Consideration, etc.

(A) In economic activities, the practice of setting different transaction prices according to the transaction quantity, terms of settlement, shipping conditions, or other factors is widely observed. It is also a general practice to set different transaction prices according to differences in the supply-and-demand balance between regions.

In light of such perspective, even when different transaction prices or transaction terms are set, it is not considered, by nature, to impede fair competition if the difference is based on a fair difference in costs, such as the difference in the transaction quantity, or reflects the supply-and-demand balance of the goods.

However, when an influential entrepreneur, in order to eliminate a particular competitor, engages in price cutting only for sales territories or customers over which said entrepreneur is in competition with said competitor, and by doing so harms the fair competition order, such act gives rise to problems concerning the Antimonopoly Act.

In addition, when an influential entrepreneur deals with a certain goods in a discriminatory manner with regard to the transaction price or any other transaction terms, without reasonable grounds, and exerts a direct and serious negative affect on the competitive function of the discriminated party, thereby impeding the fair competition order, such act also gives rise to problems concerning the Antimonopoly Act.

(B) Whether or not an individual act is regarded as Discriminatory Consideration or similar offence under the Antimonopoly Act is determined on a case-by-case basis, by comprehensively taking into consideration the intention of the person who committed the act or the purpose of the act, the extent of difference in the transaction price or transaction terms, the relationship between “the costs required for the supply” and the price, the statuses of the person who committed the act and its competitors in the market, the situation of the other party of the transaction, the characteristics of the goods, and the mode of transaction, as well as considering the harmful effect of the act on the competition order in the market.

(2) Abuse of Dominant Bargaining Position

When an entrepreneur who has a dominant bargaining position over the other party of a transaction makes use of such position to force the other party to supply goods to said entrepreneur at a low price or to defray monetary contributions for improving the said entrepreneur's settlement of accounts, such act may fall under the provisions of

Article 2 (9) (v) (Abuse of Dominant Bargaining Position) of the Antimonopoly Act.

The Fair Trade Commission will strictly deal with the Abuse based on the concepts clarified in the Guidelines Concerning Distribution Systems and Business Practices under the Antimonopoly Act (July 11, 1991; General Secretariat, Fair Trade Commission), the Guidelines Concerning Abuse of Dominant Bargaining Position in Service Transactions under the Antimonopoly Act (March 17, 1998; Fair Trade Commission), and the Guidelines Concerning Designation of Specific Unfair Trade Practices by Large-Scale Retailers Relating to Trade with Suppliers (June 29, 2005; Secretary General Notice No. 9) (Note 12).

(Note 12) Any entrepreneur who engages in the Abuse of the Dominant Bargaining Position prescribed in Article 2 (9) (v) of the Antimonopoly Act and who satisfies certain requirements, including conducting such act continuously, shall be ordered to pay a surcharge.