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BY
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I. INTRODUCTION

Despite cries of non-tariff barriers, a government subsidized export industry and a non-consumer oriented population, the unavoidable fact is that Japan has one of the largest and most sophisticated markets in the world. This fact is not entirely lost to United States businessmen; U.S. companies are continuously moving into the Japanese market, forming joint ventures, licensing technology and distributing products. Realities of Japanese business practice frequently dictate utilizing a Japanese partner for successful market penetration. Documentation of the resulting business tie-ups, however, frequently falls on American counsel. For the most part, drafting a license or distributorship agreement between a Japanese and a United States party requires the same skills of legal draftsmanship as drafting a domestic agreement. Before the client departs for Tokyo, however, U.S. counsel should be aware of specific points which may arise under Japanese law and which, if not anticipated in the documentation, may upset the business deal reached by the parties. These points are not "non-tariff barriers;" they are legal rules arising under the Japanese antimonopoly law.

If the proposed agreement between the parties is to be governed by the law of a state of the United States, Japanese domestic laws will apply to activities conducted within Japanese jurisdiction. One of these laws is the Law Relating to Prohibition of Private Monopoly and Methods of Preserving Fair Trade of Japan.[1]

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1. *Shiteki dokusen no kinshi oyobi kōsei torihiki no kakuho ni kansuru hōritsu* (Law relating to prohibition of private monopoly and methods of preserving fair trade of Japan) (Law No. 54, 1947, as amended), in 2 EHS No. 2270-2279, *reprinted in* JAPAN MINISTRY OF FINANCE, GUIDE TO ECONOMIC LAWS OF JAPAN 595 (University Publications of America, Inc.

U.S. counsel and businessmen may assume that they are familiar with the legal strictures of this legislation, particularly after learning that it was based on U.S. antitrust law.[2] In part this assumption would be justified. The American businessman who fixes prices, divides markets or ties products in Japan would suffer much the same fate under the Antimonopoly Act as under the Sherman and Clayton Acts. However, the Japanese interpretation and application of the prohibition of monopoly and unfair business practices has quite predictably diverged from the American experience. In particular, the Japanese concept of unfair business practices has developed to include practices which American business considers not only fair but indispensable in any license or distributorship agreement. It is when these concepts diverge that the parties' basic business deal is jeopardized and when counsel may be called upon to salvage the agreement by skillful drafting within the boundaries of the Antimonopoly Act.

This article will discuss a few of the most common problems encountered under the Antimonopoly Act in international license and distributorship agreements with Japanese parties. It cannot of course cover all practices which may be found to be unfair business practices under Japanese law in a particular fact situation. Practices which are clearly antitrust violations under U.S. law, such as price-fixing, tying, market division, boycotts, and predatory pricing, are mentioned here only briefly, although they are also prohibited by the Antimonopoly Act;[3] U.S. counsel can reasonably anticipate that price-fixing will be a problem. It is the unexpected interpretation of unfair business practice that will give rise to the practical negotiating problems.

These problems will be practical and immediate. Counsel will not be dealing with abstract considerations of illegality or unenforceability. He or she will be dealing with objections raised during a post-execution review of the agreement by the Japanese Fair Trade Commission (FTC).[4] The Antimonopoly Act requires that

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reprint ed. 1979), [hereinafter cited as *Antimonopoly Act*].

2. KŌSEI TORIHIKI KYOKAI (Fair Trade Institute), ANTIMONOPOLY LEGISLATION IN JAPAN 71-72 (1977). *See* D. HENDERSON, FOREIGN ENTERPRISE IN JAPAN 149-54 (1973); KANAZAWA, *Regulation of Corporate Enterprise*, in LAW IN JAPAN 480, 484-90 (A. von Mehren ed. 1963). *See generally* E. HADLEY, ANTITRUST IN JAPAN 3-19 (1977).

3. *Antimonopoly Act*, *supra* note 1, at arts. 2(9), 3.

4. The Japanese Fair Trade Commission [hereinafter FTC] is the *Kōsei Torihiki Iinkai*. For a discussion of the FTC's administrative practice, *see* KANAZAWA, *supra* note 2; and Sanekata, *Administrative Guidance and the Antimonopoly Law*, 10 LAW IN JAPAN 65

all international agreements be submitted for such review within thirty days of conclusion.[5] Antimonopoly law problems in U.S.-Japanese agreements are not resolved in litigation after performance under the agreement; they are resolved immediately over a telex machine by revising the agreement until satisfactory to the FTC.

II. The FTC Review

The Antimonopoly Act was enacted in 1947, largely under the sponsorship of the American Occupation Forces. It was based on U.S. antitrust statutes but also incorporated principles of antitrust law developed by United States courts.[6] On many points it was more severe than the parallel American provisions; for example, violations which are subject to a rule of reason in the United States were *per se* violations of the Antimonopoly Act as originally enacted.[7] Later amendments mitigated the severe objective rules however, and eliminated prohibitions incompatible with Japanese business practices.[8]

The present Act has approximately one hundred articles in ten parts. Areas of regulation include private monopoly trade associations, interlocking business relationships and unfair business practices. Supplementing the Act are FTC Guidelines and Notifications on specific topics. Both the Act and the FTC Guidelines are available in semi-official English translation.[9]

Practice under the Antimonopoly Act is hampered by the almost complete lack of court decisions interpreting the Act and the Guidelines. As of 1977, only thirty-one cases in all areas of Antimonopoly law had been brought in the Tokyo High Court.[10] Unlike American antitrust law, the Japanese legislation is essentially an administrative law enforced by government personnel in private consultation with the parties.

The responsible government agency is the Fair Trade Com-

(1977).

5. *Antimonopoly Act*, *supra* note 1, at art. 6(2).
6. Kōsei Torihiki Kyokai, *supra* note 2, at 71.
7. D. Henderson, *supra* note 2, at 148-50.
8. Kōsei Torihiki Kyokai, *supra* note 2, at 71.
9. The publishers of the EHS (*Eibun-Hōrei-Sha, Inc.*) Law Bulletin Series, Tokyo, Japan, publish an English translation of the Antimonopoly Act and FTC Notifications and Guidelines. Although the translation is prepared by FTC staff, it is an unofficial translation.
10. Kōsei Torihiki Kyokai, *supra* note 2, at 95.

mission established under Chapter VIII of the Act. The Commission consists of five members appointed by and administratively answerable to the Prime Minister.[11] In fact the FTC is an unusual regulatory branch of the Japanese government in which most regulatory work is performed by the Ministry officers. Perhaps because of its unusual status, the FTC has expanded slowly, now operating with 513 employees in three administrative departments: the Economic Department, the Trade Practice Department, and the Investigation Department.

The FTC is empowered with investigative and direct regulatory powers. Pursuant to Article 49 of the Act, it may issue complaints against entities alleged to be in violation of the Act, conduct hearings, and order cease and desist or other measures necessary to eliminate the violation.[12] Enforcement may be aided by court injunction.[13] Violations of the Act are also criminal violations and criminal proceedings may be commenced on complaint of the FTC.[14] Although the FTC prefers to work through persuasion and recommendation, it is a fully empowered regulatory agency which cannot be disregarded when operating in Japanese jurisdiction.

Foreign business encounters FTC regulatory powers during the review required by Article 6 of the Act. Article 6 reads in part as follows:

Article 6 [Prohibited international agreements]

> (2) An entrepreneur who has entered into an international agreement or an international contract, shall, in accordance with the Rules of the Fair Trade Commission, file a report thereof with the Commission, accompanied by a copy of the said agreement or contract (in the case of an oral agreement or contract, a document describing the contents thereof), within thirty days as from the execution of such act.
>
> (3) The provisions of the preceding subsection shall not apply to an agreement or contract regarding a single transaction (excluding such transactions of which the delivery of goods extends over a period of one year), or to an agreement or contract merely creating an agency in business matters (excluding an agreement or contract containing conditions that restrict the business activities

11. *Antimonopoly Act, supra* note 1, at arts. 28, 29(2).
12. *Id.* arts. 45 to 70-2.
13. *Id.* art. 67.
14. *Id.* art. 96.

of the other party).

Curiously, the origin of this provision was a plan to curb activities of the powerful Japanese trade associations which had operated internationally prior to the Pacific War.[15] Article 8 of the Act still specifically prohibits trade associations from entering into international agreements in restraint of trade. However, the filing requirement was not expressly limited to a particular class of contract parties and on its face requires all Japanese entities to comply. In 1971, the FTC issued a concise notification restating the Article 6 filing requirement for all international agreements.[16]

Until relatively recently, the Article 6 review was of minor importance insofar as it followed a more stringent approval process conducted by the Japanese Foreign Investment Council. The FTC was represented on the Council and antimonopoly questions were essentially disposed of during the Council review. Liberalization of international trade and investment has, however, relaxed the Council approval process. Present government approval requirements are limited to a routine notice and approval by the Ministry with jurisdiction over the industry.[17] After this change, the Article 6 review by the FTC acquired a more significant place in the parties' planning.[18]

In light of the above, it should be emphasized that the FTC review is a review only, not an approval requirement. Except for unusual cases, the agreement must be executed by the parties and legally binding (subject to subsequent approval of the Japanese Government where applicable) prior to submission to the FTC. There is no bar on the parties' commencing performance under the agreement while the review is pending. Since the FTC may take several months to complete the process, most parties in fact do commence operations under the agreement.

The obligation to submit an agreement for review is on the Japanese party. Unless the foreign party is otherwise doing business in Japan through a subsidiary or branch office, it has no duty to participate in or to verify the submission of the agreement to

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15. D. HENDERSON, *supra* note 2, at 153.

16. *Kokusai-teki kyotei mata wa kokusai-teki keiyaku no todokeide ni kansuru kisoku* (Regulation concerning filing a report of an international agreement or international contract) (FTC Reg. No. 1, 1971), in 2 EHS No. 2279.

17. *Gaikoku kawase kanrirei* (Cabinet order regarding foreign exchange control) (Cabinet Order No. 203, 1950), in 5 EHS No. 5050.

18. D. HENDERSON, *supra* note 2, at 154.

the FTC. In practice, however, counsel for the foreign party should urge prompt submission. If the FTC is going to raise objections to provisions of the agreement, the foreign party whose technology is being disclosed or whose products are to be shipped to Japan will not want to learn of the legal difficulties a year or two into performance.

The submission process itself is relatively simple. An original or verified copy of the agreement and a Japanese translation are delivered to the FTC offices together with a brief summary of pertinent provisions on an official FTC form. Three forms are available from the FTC: one each for license agreements, distributorship agreements, and all other international agreements, including joint venture agreements. Counsel for the foreign party should be aware that these forms contain space for the filing party to indicate such agreement terms as non-competition clauses, territorial restrictions, raw material purchase requirements, and other provisions which may in fact raise issues under the Antimonopoly Act. Thus the possibility that the FTC will overlook an objectionable provision in the parties' agreement is substantially diminished.[19]

Usually, the first notice that the United States or other foreign party has of an FTC problem is a letter or telex from its Japanese partner. The communication typically announces that certain provisions of the heavily-negotiated and already executed agreement must be amended in accordance with an FTC recommendation. Some of the provisions which commonly suffer this fate are discussed below.

III. FTC Guidelines

To assist both Japanese and non-Japanese parties in avoiding provisions which constitute unfair business practices, the FTC has issued two sets of Guidelines for international agreements.[20] The

19. Despite the information specified in the filing form, the FTC does occasionally fail to object within the normal time period to provisions essentially identical to provisions previously objected to in other agreements. This enables the parties to retain and legally enforce the provision as part of their agreement. However, because there is no time limit on FTC objections, the parties should be advised that the FTC may raise the question and require amendment months or even years after the filing date.

20. *Kokusai-teki gijutsu donyu keiyaku ni kansuru nintei kijun* (Antimonopoly act guidelines for international licensing agreements) (FTC, May 24, 1968), *reprinted in* H. Iyori, Antimonopoly Legislation in Japan 199 (1969) [hereinafter cited as *Licensing Guidelines*]; *Yunyu sodairiten keiyaku to ni okeru fukoseina torihiki hoho ni kansuru nintei kijun* (Antimonopoly act guidelines for sole import distributorship agreements)

Guidelines are advisory only, as is evident from the language of the introductory paragraphs. The enumerated practices are described as "[a]mong the restrictions which are liable to come under unfair business practices."[21]

The description of these objectionable restrictions in the Guidelines is generalized and extremely vague. There are no examples. Interpretation is entirely within the discretion of the FTC and it is important to note that the interpretation and application have occasionally changed without revision of the Guidelines themselves.[22] For foreign legal counsel, the Guidelines rarely give sufficient guidance concerning the FTC position to enable effective legal counseling. Nonetheless, the specific problems which are discussed in detail in this article are referred to in the Guidelines, which serve as a convenient starting point in understanding the substantive content of the FTC review process.

The Antimonopoly Act Guidelines for International Licensing Agreements were issued in 1968. The short, three article, 561-word Guidelines list a total of nine restrictions wich are liable to come under unfair business practices in the licensing context. One of the objectionable restrictions involves controlling the Japanese licensee's export of goods produced under the license. However, restrictions are permissible if the licensor has patent protection in, is selling directly into, or has licensed a third party in the restricted territory.[23] Four of the additional objectionable restrictions are essentially tying and resale price maintenance provisions.[24] Also subject to FTC objection are provisions requiring payment of a royalty on goods not utilizing the licensed technology.[25] The foregoing six restrictions are not frequently cited by the FTC in the review process. The majority of FTC objections focus on the remaining three prohibited restrictions: grant-back obligations of the licensee,[26]

(FTC, Nov. 21, 1972) [hereinafter cited as *Distributorship Guidelines*].

21. *Licensing Guidelines, supra* note 20, at art. 1. The language of the Distributorship Guidelines is slightly different: "[a]mong the restrictions which are likely to constitute unfair business practices . . . ." *Distributorship Guidelines, supra* note 20, at art. 1. There is no evidence that this difference reflects a substantive difference in FTC administrative practice under the Distributorship Guidelines.

22. The Japanese bar learns of changes in FTC interpretation or application of the Guidelines when the Commission objects to a previously acceptable provision. FTC staff may also indicate a policy change in a public address or interview.

23. *Licensing Guidelines, supra* note 20, at art. 1(1)(a)-(c).

24. *Id.* arts. 1(2), 1(4)-(6).

25. *Id.* art. 1(8).

26. *Id.* art. 1(7).

non-competiton clauses,[27] and quality control provisions.[28]

The subject matter and scope of the Antimonopoly Guidelines for Sole Distributorship Agreements are similar to the Licensing Guidelines. Also consisting of three articles and totalling 485 words, the Distributorship Guidelines list six restrictions which are likely to constitute unfair business practices in continuous import and sale agreements. Restrictions on resale prices[29] and class of purchaser[30] are subject to challenge. Obligations to purchase parts, ingredients, attachments, and other items from the contract party are objectionable except in the case of component repair parts.[31] Restrictions on parallel import[32] and termination clauses are included among the six.[33] The most commonly cited prohibited restriction however, is the non-competition clause restriction on dealing in competitive goods.[34] The Guidelines do permit such restriction but only in certain circumstances.

In summary, the three areas in which foreign licensors and manufacturers most frequently encounter problems under the Guidelines are grant-back license provisions, non-competition clauses, and quality control. The foreign party to the agreement is usually unprepared for the FTC interpretation of these points in the Guidelines. To fully comprehend the precise requirements as developed under FTC administrative practice it is necesary to examine the types of provisions which are objected to by the FTC.

A. *Grant-Back License Provisions*

The grant-back license of all improvements by and know-how of the licensee is a contract provision basic to the goals of every licensor. In a superior marketing position, (in control of marketable patents and technology), the licensor demands and usually gets rights to the licensee's developments on terms favorable to the licensor. The licensee, eager to get the technology and only dimly aware of its potential contribution usually gives away, if not the world, then certainly that part of it which may be called its im-

27. *Id.* art. 1(3).
28. *Id.* art. 1(9).
29. *Distributorship Guidelines*, *supra* note 20, at art. 1(1).
30. *Id.* art. 1(2).
31. *Id.* art. 1(3).
32. *Id.* art. 1(4).
33. *Id.* art. 1(5).
34. *Id.* art. 1(6).

provements. A typical grant-back provision found in a 1956 agreement between a U.S. licensor and a Japanese licensee reads as follows:

> Licensee agrees to grant and hereby grants to Licensor an exclusive, royalty-free, world-wide irrevocable right and license under Licensee's Patent Rights and Technical Information; together with the royalty-free, irrevocable right to grant such right and license to others; provided, however, that Licensee reserves the right to use its own Patent Rights and Technical Information in its own operations in all countries of the world.

Today the above clause would almost certainly fail to survive the FTC Article 6 review.

The FTC approach to grant-back provisions is initially to prohibit all such provisions as unfair business practices. The Guidelines then make the following proviso: "However, such cases are excluded [from the FTC ban] where the licensor bears similar obligations and the obligations of both parties are equally balanced in substance."[35] The key to protecting the foreign licensor's grant-back rights is to comprehend the meaning of this language as applied by the FTC. The concept is a surprisingly rigid interpretation of mutality and equality that has sent many well-drafted agreements back into the word processor.

The above-quoted proviso does not mean that the grant-back is acceptable to the FTC simply because the licensor obligates itself to disclose improvements developed by it subsequent to the initial transfer of technology. To be sure, that is the minimum requirement imposed by the phrase "the licensor bears similar obligations." The licensor who wishes to transfer technology without improvements had better resign itself to ignorance of its Japanese licensee's developments. This rule is absolute even in fact situations where presumably the Japanese party is not concerned with improvement technology. An example is a license granted under an equipment manufacturing and supply agreement. The licensor under such an agreement may want the licensee in question to manufacture equipment which does not incorporate the latest technology. The licensee is presumably content to do so for the contract price. The licensor as a matter of course wants any improvements the licensee may discover during the manufacturing process, but it does not want to be under an obligation to disclose

35. *Licensing Guidelines, supra* note 20, at art. 1(7).

its latest technology. The licensee is not, after all, even using the equipment in question. The logical arguments against mutuality notwithstanding, the Japanese FTC will not permit a one-sided obligation on the part of the licensee. For the licensor in this fact situation, the required mutuality can be a serious obstacle to proceeding with the agreement.[36]

Most licensors are not in this extreme position. They are willing to disclose improvements to their licensees as a natural aspect of a technology license. They may still, however, encounter serious obstacles as a result of the FTC's concept of obligations "equally balanced in substance." At first the equality demanded may seem relatively straight-forward. In one licensing agreement, the licensor agreed to disclose "all proprietary information relating to the production of the Products" whereas the licensee was required to disclose "all information developed by it relating to production of the Products." The FTC cited this language as "unfair as to the scope of the technology" because "proprietary" was omitted from the licensee's obligation. Whenever possible within the agreement of the parties, strict parallel structure should be adopted when drafting grant and grant-back provisions.

The simplicity of the foregoing example is, however, misleading. The FTC views the test of equality not only in the context of specific grant and grant-back provisions but within the entire framework of the license agreement. Considered in light of termination rights, territorial limitations, royalty obligations, and other aspects of the parties' agreement, substantial equality is in fact an extremely complex concept. Under FTC review standards, the equality must extend to all parts of the agreement and it must be maintained throughout the performance, termination, or expiration of the license.

One example of how this concept can disrupt the parties' business deal involved a license agreement for a popular American confection. Under the terms of the agreement, the licensor granted the licensee an exclusive license for an initital ten year term, renewable for an additional ten year term at the option of the licensee. At the

36. This example and all examples in the text are drawn from actual case histories of transactions between foreign and Japanese parties involved in the FTC Article 6 review process. In some examples details such as the product involved or the nationality of the foreign party have been changed to preclude identification of the actual transaction. The business aspects of some examples have also been simplified to eliminate terms not relevant to the discussion. Files on the transactions discussed are not available to the public.

end of the twenty year term but not the ten year term, the licensee was to have a paid-up license to the technology. The licensor agreed to disclose all relevant technological information and to provide the licensee with all improvements developed during the effective term or terms. The licensee on its part agreed to make royalty payments and to develop the Japanese market. It further agreed to grant the licensor an irrevocable, royalty-free, and non-exclusive right to use the licensee's improvements in all territories of the world excluding Japan. The parties prudently provided that the grant-back license would terminate in the event the agreement was terminated due to a breach by the licensor. That did not, however, save the clause from FTC attack.

The FTC objected to this agreement based on its unannounced, but generally applied rule that a licensor should not be able to use the grant-back technology at any time after the licensee loses its rights to use the core technology. Once this unwritten rule is known, the analysis of the problem presented by the confection license is quite simple. If the licensee opted not to renew the license for the second ten year term, it would lose all rights to the licensor's technology. In contrast, the licensor could continue use of the grant-back technology for as long as it was commercially viable. The FTC recommended amendment to require the licensor to cease use of grant-back technology upon notice of licensee's intent not to renew. Alternatively, the FTC would have approved the grant-back term as submitted if the licensee were given paid-up rights after the initial ten year term.

Other amendments to remedy the inequality were considered by the parties. The agreement could have provided for a straight twenty year term with appropriate royalty adjustments. The parties considered retaining the original term provision but providing for a royalty on the grant-back technology in the event the licensee did not renew. All possible alternatives presented difficulties from a business viewpoint and ultimately the licensor agreed to cease use of the grant-back technology in the event of non-renewal. The licensor thus accepted an agreement less favorable than the licensee itself had originally been willing to conclude. This result could have been avoided if the licensor had knowledge of this problem prior to negotiation with the licensee.

Though duration of rights to technology must be rigidly equalized, the FTC does adopt a unique form of flexibility on some agreement terms. The primary example of this concerns the territory in which the licensor and licensee may use their respective license rights. This is illustrated by an agreement which grants the licensee exclusive rights to the Japanese market with a world-wide but non-exclusive grant-back to the licensor. Although on first consideration this may appear to be an inequality, the FTC has a high regard for exclusivity and will permit the exclusive aspect of a license to balance other ostensible inequalities in the licensed territories. Accordingly agreements with the above territorial provisions are routinely passed without objection by the FTC.

Counsel should be wary however, of any conditions or limits on the all-important exclusivity. As one United States cosmetics manufacturer found to its regret, the territorial inequality is tolerated only as long as the exclusivity is in effect.

The cosmetics license as executed gave the Japanese party a fifteen year exclusive license for the Japanese market, conditional on achievement of an annual minimum royalty. One section of the agreement provided that the license would become non-exclusive at the option of the licensor upon failure of the licensee to achieve the minimum royalty amount in any one year period. The American party received a royalty-free grant-back license for use in all territories of the world excluding Japan. During its review of the agreement, the FTC focused on that section and declared that exclusivity was not assured the Japanese party. To restore substantial equality, the FTC recommended a provision that in the event the section was relied upon to cancel the licensee's exclusivity, the licensor's use of the grant-back technology would be limited to the United States. Because the FTC's suggestion was not acceptable to the U.S. party, the section was deleted in its entirety.

Having struggled with what may appear to be the FTC's tit-for-tat mentality in pursuit of substantial equality, the non-Japanese party must sometimes learn another distressing aspect of the equality standard. The FTC as a Japanese government agency is mandated to protect the Japanese market from unfair business practices. It has no duty to prevent unfair business practices which affect other markets. "Other markets" includes the foreign party to an international agreement. In short, the FTC will not raise points of inequality which are favorable to the Japanese party and detrimental to the non-Japanese party only.

This point was illustrated in the cosmetics licensing agreement discussed above. Apart from the option ultimately deleted, the terms of that agreement resulted in the Japanese party acquiring a royalty-free, world-wide, paid-up license for the technology at the conclusion of the fifteen year term. The U.S. party received and retained a royalty-free license for the world excluding Japan. In this fact situation, the foreign party waits in vain for the FTC to object and recommend removal of the exclusion of Japan or limitation on the licensee's rights in the U.S. Since the United States Federal Trade Commission is unlikely to intervene on the licensor's behalf, counsel for the U.S. party must apply the substantial equality rule on behalf of its client during the negotiation period for the desired result.

As the above examples illustrate, grant-back provisions of licensing agreements are a fertile source of FTC objections. The licensor's ability to tie up improvement technology is carefully limited by the FTC Guidelines enforced through the Article 6 review. Yet for the licensor the grant-back is an essential provision to the agreement, without which it may fall behind its licensee in technological innovation. In drafting the grant-back, counsel for the licensor should therefore weigh each term of the agreement to assure that the FTC rule of substantial equality is met on terms most favorable to his or her client.

B. Non-Competition Provisions

Objections to non-competition clauses arise under both license agreements and distributorship agreements with Japanese parties. For the foreign corporation introducing its technology or its products into Japan such clauses have two important functions. First, a non-competition clause is essential to assure that the Japanese party will utilize its technology or promote its products to the exclusion of competing technology or products. Second, the foreign licensor or manufacturer must be assured that the Japanese party will not become a competitor immediately after termination of the agreement. To achieve these goals, however, counsel for the foreign party will have to draft successfully within the FTC guidelines.

As in the case of grant-back clauses, the FTC position starts from an outright ban on such restrictions in license or distributorship agreements.[37] For the manufacturer or licensor not willing to grant an exclusive status to the Japanese party, the ban is absolute. The FTC will require deletion of a non-competition clause in

37. *Licensing Guidelines, supra* note 20, at art. 1(3); *Distributorship Guidelines, supra* note 20, at art. 1(6).

any non-exclusive licensing or distributorship agreement for the Japanese market.

If, however, the foreign party is willing to grant exclusivity, the exclusive right can balance the competitive restriction on the Japanese party. This is the same principle which permits exclusivity to balance unequal territorial grants in the grant-back context. Thus the FTC will approve the following provision in an exclusive distributorship or licensing agreement:

> [Japanese Party] will not undertake the manufacture, import or sale in the Territory of products competing with the Products as herein defined during the term of the Agreement.

The licensor or manufacturer who has bought non-competition with exclusivity may suspect that its right to enforce that provision lasts only as long as the exclusivity. That is correct. If there are conditions in the agreement which permit a change to non-exclusivity, the FTC will recommend an amendment to the non-competition clause permitting use of competitive technology or products by the non-exclusive licensee or distributor.

For non-competition to be absolute, the exclusivity must also be absolute. Even the manufacturer or licensor must be completely excluded from the Japanese market. A European liquor manufacturer recently entered into a distributorship agreement with a major Japanese beverage wholesaler for essentially exclusive representation of its premium cognac. The agreement contained a non-competition clause carefully drafted to cover only other high-quality cognac products. Up to this point, the FTC would have no objection to the agreement terms. However, the manufacturer then decided for convenience to retain direct sales rights to certain airline and ships stores accounts which it served on a world-wide basis. As a result of that reservation, the Japanese distributor acquired the right to represent competing cognac to the same airline and ships stores accounts.

Since the above case involved well-known trademark products, the result was acceptable to the parties. A U.S. party marketing engineering services in Japan, however, found that the resulting right of its sales agent to represent competitors to some accounts created an impossible marketing situation. Since direct contact with some accounts was important to its customer relations, the entire representative agreement had to be reconsidered by the parties.

In addition to the exclusivity prerequisite, the FTC Guidelines require exclusion from the non-competition clause of all technology or products already used, manufactured, or sold by the Japanese party. This aspect of the business agreement has usually been considered by the parties during negotiations and presents few problems. The exclusion should, however, be expressly stated in the agreement, even when the fact situation may appear to make it unnecessary. Recently, a United States food products manufacturer included the standard non-competition clause in its license agreement with a new Japanese licensee. The clause did not mention existing products. The licensed technology involved was for a distinctive line of American cookies: delectable concoctions of chocolate chips, peanut butter, and other standard American ingredients. After the FTC review and objection, and after lengthy telex exchanges between the parties, the following language was inserted:

> For purposes of this article, *sembei* and *okoshi* already manufactured by Licensee shall be deemed not to compete with the Products.

From the licensor's viewpoint, there had never been any doubt that the traditional Japanese crackers and tea cakes would not be directly in competition with the American cookies.

The above two aspects of the non-competition clause relate principally to support of the product during the term of the agreement. In fact there is little purpose in discussing agreement term restrictions on competition after termination. The FTC will not permit this type of non-competition clause under any circumstances.

Clauses prohibiting competition after termination are most important in those industries which rely on trade secrets, know-how, and extensive specialized market development. There is always a substantial risk that the licensee or distributor will utilize the know-how gained during the agreement term to launch its own products in direct competition with the licensor's or manufacturer's products. At first, the FTC permitted foreign parties to place restrictions on sales by Japanese licensees and distributors. Subsequently, however, the FTC established, and thereafter with time has shortened, the permissible restriction period—first to three years, then two years, and finally one year from termination. Even this has now been eliminated. At the present time, competitive restrictions may not extend beyond the term of the agreement unless the license is terminated for default by the licensee. Licensees in default may still be restricted for a two year period or until the end of the stated license term, whichever occurs first. Licensors and manufacturers sensitive to the competitive threat from former contract parties must adopt alternative methods of protecting their trade secrets and know-how.[38]

In one recent matter involving this FTC position, a consumer health products manufacturer found itself without competitive protection from a licensee it had essentially put into the field. The agreement, which was already in operation between the parties, stipulated as follows:

> Distributor agrees that it shall not during the continuance of this Agreement and for one year after its termination without the previous written consent of the Company engage in the manufacture, sale or distribution of any products sold to the consumer health care market which are directly or indirectly competitive with the Company's Products.

Four years after the agreement was filed, the FTC contacted the Japanese party and took a very strong position that the phrase "and for one year after its termination" had to be deleted from the agreement. After extensive negotiation with the FTC reviewer, the manufacturer agreed to delete the objectionable phrase. At the same time, however, it won FTC approval for addition of the following clause:

> Distributor further agrees that following the termination of this Agreement it will not thereafter, directly or indirectly in any manner whatsoever package a product so as to duplicate or resemble the Company's Products nor utilize, use or make known or available to any third party, the confidential information which has been disclosed to it hereunder.

Although more difficult to enforce than a non-competition clause, this language gave the U.S. party a legal basis for challenging the licensee's conduct if the latter began duplication of the licensed products after termination. This approach should be considered during negotiations of any agreement with the Japanese party

38. Restrictions on use of proprietary information are generally necessary to protect the owner's rights in agreements with Japanese parties. In addition to the FTC considerations, Japanese law permits free exploitation of proprietary information after termination or expiration of the agreement unless the agreement expressly provides otherwise.

which involves extensive use of trade secrets and know-how.

In conclusion, it is relatively simple to summarize the strategy which should be used by the foreign party in obtaining competitive protection from a Japanese licensee or distributor. The licensor or manufacturer should select a Japanese partner not already manufacturing or distributing competing products (although some licensors have felt more comfortable with a licensee which has experience in the field), make the representation exclusive for the Japanese market, and then place every possible restriction on the Japanese party's use or disclosure of know-how, trade secrets, and technology. By using this approach, the foreign party will be able to preclude competition during the agreement term and control its proprietary information after termination. Other more direct approaches to non-competition are foreclosed by the FTC.

C. *Quality Control Provisions*

Quality control provisions are standard fare in licensing and manufacturing agreements. In some cases, control is necessary to ensure that the licensed technology will work. In others, the clause is included to protect the licensor from the unenviable result of shoddy merchandise entering the market under its trademark. The licensor's power to control its licensee's quality is, however, another area in which the FTC has final say.

In a now familiar pattern, the FTC Guidelines for International Licensing Agreements first prohibit all restrictions on quality of raw materials and parts, etc., or of the patented goods. The Guidelines then set forth the following proviso:

> However, such cases are excluded where such restrictions are necessary to maintain the credibility of the registered trademark or to insure the effectiveness of the licensed technology.[39]

The question of course is how to draft the agreement to come within the proviso.

Drafting may in fact be the key to an uneventful FTC review of the quality control provision. Actual experience indicates that the FTC is more concerned with phrasing and expression of the quality control clause than with the underlying need for quality control. Successful in passing the review have been requirements of "high quality" or other objective measure of quality level. For

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39. *Licensing Guidelines, supra* note 20, at art. 1(9).

example, the following clause was passed by the FTC without objection:

> Licensee agrees to maintain the highest standards of technical excellence and quality of its Products. In connection therewith, Licensor shall be supplied, upon request, with samples of the licensed Products for the purpose of determining that the quality thereof is on the same level as the standard set by the Licensor and Licensee for the Japanese market.

The references to jointly agreed standards and to the seemingly neutral "highest standards of technical excellence" were apparently sufficient to preclude FTC objection. However, the following clause did not fare as well:

> Licensee shall manufacture and/or assemble Products in accordance with Licensor's Standards and the Products so manufactured or assembled shall perform in accordance with Licensor's Standards.

The FTC required deletion of the entire clause. Apparently the FTC concluded that this language gave the licensor excessive arbitrary power to control the licensee's production or even to terminate the license for failure to meet the licensor's subjective standards.

The disparate treatment of the above clauses was certainly not due to an FTC conclusion that the technology and trademark in the first case justified stricter quality control. The first clause quoted above was part of a license for an American snack food. The second clause was found in a license for highly technical equipment used in nuclear plants.

These and other cases suggest that the stated basis for coming within the Guidelines' proviso are relatively easily met in the typical license agreement. There is, however, an unwritten requirement that the quality control clause be as objective and self-operating as possible. Clauses giving the licensor the power to judge and reject the licensee's products may be subject to FTC objection. Neutral requirements to meet high standards can be structured to give much the same result as unilateral clauses and are more likely to pass FTC review.

The cautious draftsman will meet both the written and unwritten requirements. Recitations regarding the need for quality control are advisable to establish a firm basis for the imposition of the restriction. Then counsel can exercise imagination in the imposition of highest standards of quality.

IV. FTC Objection Procedure

The Japanese party is the first to learn of an FTC objection to an agreement provision. As the party which filed the agreement, it will be informed of the FTC objection, usually within two or three months of the filing date. The FTC will indicate the objectionable provisions and recommend that they be deleted or amended to comply with Japanese law. The initial communication is advisory in tone and often presented as a suggestion that the parties "study the recommendation and report to the FTC in due course."[40]

The Japanese party's reaction to the objection will depend on the status of its relations with the foreign party and the degree to which the recommended change is beneficial to its interests. In one case of FTC objection, the Japanese licensee realized that the requested amendments would jeopardize an excellent business relationship and possibly preclude licenses for additional products. It accordingly took a very strong position with the FTC, and argued (1) that the FTC had not objected to similar provisions in previous agreements; (2) that the time lapse between filing and the objection was too long; and (3) that its "credit" with the licensor would be seriously affected. Not one of these arguments had any legal basis. The FTC is free however, to reinterpret its Guidelines at any time and frequently does so. Further, there is no time limit on its review procedures. Theoretically, it can find violations of law at any time during and even after the agreement term. Finally, though the third argument was not a legal argument in any form, the FTC conceded these points in private discussions with the licensee, and agreed to modify its request for amendment. Though the FTC's action in this case may have reflected a weak legal basis for the specific objections, the compromise clearly would not have occurred if the Japanese party had not taken a strong defensive stance.

The above example is hardly the typical case. Partly because the change will be beneficial to it and partly because of Japanese reluctance to oppose the FTC bureaucracy, the Japanese party is more likely to contact the foreign party and request amendments to the agreement in accordance with the FTC recommendation. If

40. Quotation from a translation of a letter from the Fair Trade Commission to the Japanese party of an international agreement under review.

the FTC has a sound legal basis for its objection, the Japanese party cannot be faulted for seeking compliance. There have unfortunately been cases in which the Japanese party has apparently cooperated too closely with the FTC. In these instances the foreign party has had reason to suspect that the provisions objected to were in fact pointed out to the FTC by the Japanese party with the intent of forcing amendment. These cases are rare, however, and generally the foreign party should consider the Japanese party's position sympathetically. The FTC is a government agency with broad jurisdiction over Japanese business and extensive enforcement powers.

Even if the Japanese party is not prepared to do full-dress battle, it is not necessary to capitulate completely to the FTC recommendations. The parties may enter into discussions with the FTC reviewer to clarify the exact parameters of the objection and to reach a compromise on the requested changes. There have been instances when the FTC has misunderstood the language of the agreement and discussions have obviated the requirement to amend. Frequently discussion will result in less drastic modifications to the agreement than originally proposed in the FTC letter. Very rarely, the FTC will back down from its position. If changes are to be made in the agreement, the alternative or additional language can be discussed and given prior clearance by the reviewer. This has the desirable effect of precluding a reoccurrence of the objection. The discussion process is a well established procedure in FTC practice and should be considered by the parties as the equivalent of their day in court. As is further discussed below, it is the only opportunity for the foreign party to inject its views in an attempt to alter the final result.

It is essential, then, that the foreign party have effective representation during the FTC discussion. For reasons that may be all too obvious, the process should not be left to the Japanese party's representative. As the FTC reviewer will strongly prefer to speak in the Japanese language at the meeting, Japanese counsel or the services of a Japanese affiliate are usually necessary to convey the foreign party's viewpoint.

The meetings and discussions with the FTC can be held over a period of several months before the Agency will take any further action. The FTC prefers to obtain results by persuasion rather than by formal order and will therefore delay issuing an order until the possibility of voluntary compliance is exhausted. The time gained can be used by the parties to reach compromises on a business level including readjustment of the terms of the agreement to reduce the need for the objectionable provisions. During the negotiation period, the provisions in question will remain enforceable between the parties.

If the discussions fail, the FTC will conduct a hearing and eventually will issue an order to cease and desist or take any other measure deemed necessary to eliminate the violation.[41] Cases in which such orders were issued are rare, but that fact is undoubtedly due to the high rate of voluntary compliance and not to any legal difficulties in obtaining the order. The order will be directed against the Japanese party, which then has very little option but to obtain amendment of the agreement or breach. If it does not comply, it is subject to court order and its officers may be subject to criminal proceedings initiated by the FTC. Most Japanese businessmen prefer to avoid involvement with court proceedings, particularly proceedings in which they are criminal defendants.

It is possible to challenge the FTC order in court. Under Article 11 of the Act, decisions of the FTC are subject to court review. Suit must be filed in the Tokyo High Court within thirty days of the effective date of the FTC order.[42] The Court then requires transfer of the FTC record and findings of fact for its review.[43] However, the Court's review of the record is limited by statutory provision. Decisions will be invalidated only if not supported by substantial facts or if inconsistent with the Constitution or other laws.[44] The scope of the review is intended to give the FTC a large area of discretion within which to develop its policy objectives.

One important caveat must be put on the right of review. In 1971, a Danish company brought suit in the Tokyo High Court, seeking review of an FTC order which directed deletion of provisions from its license agreement with a Japanese licensee. The suit was dismissed by the Court on the grounds that the Danish company had no standing to challenge the order. The Court ruled that the Japanese company, as the party named in the FTC order, had sole right to seek the Court review.[45] Since the Japanese party will

41. *Antimonopoly Act, supra* note 1, at arts. 45 to 70-2.

42. *Id.* art. 77.

43. *Id.* art. 78.

44. *Id.* art. 82.

45. Novo Industri A/S v. Kōsei Torihiki Iinkai, in *Hanrei Taimuzu* (No. 264) 215-17 (Tokyo High Court 1971) [this case is discussed in the *Interim Report by the Committee on*

almost always be the respondent in the FTC action, the foreign licensor or manufacturer is essentially precluded from the court remedy. And it will not be easy in most cases to convince the Japanese party to seek review. The Japanese party will consider that the important battles must be waged during discussions with the FTC reviewer. The foreign party is well advised to adopt the same attitude.

V. ALTERNATIVE APPROACHES

If the above-described review procedure gives the prospective licensor or exporter to Japan serious doubts, there are alternative ways to approach the Article 6 requirement which afford the parties additional flexibility. These are not appropriate in all cases, but should be considered if an FTC objection seems probable.

If the provision which may be objectionable is absolutely critical to the parties' agreement, it is possible to avoid the Article 6 review entirely. The foreign party has only to establish a Japanese branch office or subsidiary to enter into the agreement with the Japanese party. If the two signatories are both Japanese legal entities, the agreement is not an "international agreement" within the meaning of Article 6 and no filing is required.[46] The agreement may then contain provisions which the FTC would not permit. Such provisions are, however, entirely enforceable between the parties.

This method of circumventing the FTC review is of course expensive. Japanese subsidiaries may not be formed off-the-shelf. Japanese counsel must be retained, capital invested, and considerable personnel time expended in setting up the subsidiary. Establishing a branch office also requires legal services and adequate financing. Some licensors with extensive business in Japan have found it expedient to set up Japanese subsidiaries, but it is not a solution in most Article 6 objection cases.

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the Extra-territorial Application of Restrictive Trade Regulation, reprinted in 16 JAPANESE ANN. INT'L L. 70, 70-72 (1972)]; *aff'd,* 29-10 Sai-han Minshu 1592 (Supreme Court 1975). The Supreme Court affirmed on the same grounds but distinguished between cases in which the FTC has issued its order based on acquiescence of the Japanese party to the FTC recommendation and cases where the order is issued after a full hearing. The *Novo* case involved an order issued after the Japanese party accepted the FTC recommendation. The Supreme Court decision thus left open the question of whether or not the foreign party could seek review of an order issued after a hearing.

46. *Kokusai-teki kyōtei mata wa kokusai-teki keiyaku no todokeide ni kansuru kisoku, supra* note 16.

For companies obliged to undergo the Article 6 review, one of the most problematic aspects is that the review takes place after performance under the agreement has already commenced. Thus the licensee is already in possession of the know-how, or the distribution network has already been set up when the foreign party learns that the agreement must be rewritten. If the licensor or manufacturer is particularly concerned about the timing factor, it is possible to obtain pre-review clearance of an agreement.

Technically under the FTC Notification concerning filing of international agreements, the agreement must be executed by the parties prior to submission. However, on request the FTC reviewers will meet with the parties and will examine provisions which the parties believe might be objected to during the formal review. For obvious reasons, the parties should request FTC examination of all provisions even remotely susceptible to FTC objection. Within a relatively short time after the meeting, the FTC will inform the parties whether or not it considers any of the specified terms objectionable. If the FTC response is negative, the parties may proceed with execution and performance without concern that amendments will be required at a later date. If the FTC indicates that it considers any of the specified terms objectionable, the parties can adjust their agreement or even call off the arrangement without damaging their business positions.

As in the first alternative discussed above, the pre-review clearance involves cost and expenditure of time by the parties. The foreign party will usually be required to have Japanese counsel or other representative in Tokyo to attend the meetings with the FTC. Because of the procedural burden, this alternative is useful to high technology licensors unwilling to risk disclosure of know-how without assurance of exact agreement terms. It may not be warranted in the case of an ordinary license or distributorship agreement.

The final alternative approach carries considerable risk, and opinions of Japanese counsel differ on its effectiveness. If the possible FTC objection involves the terms of a grant-back provision, some Japanese counsel believe that the grant-back may be effectively separated from the main license agreement and embodied in a separate agreement. The new agreement would in effect be a license agreement in which the Japanese party is the licensor. Under a Cabinet Order issued by the Japanese government, Japanese companies are specifically permitted to enter into an international license for their technology, subject only to government review of the adequacy of the consideration.[47] It is generally believed that business opportunity or other intangible consideration will be adequate for such a review. In this way the FTC "substantial equality" rule is avoided, giving the parties more room in which to structure a satisfactory business arrangement.

Japanese counsel advise that it is possible that the FTC will eventually merge the two license agreements, (the new license agreement is also an international agreement and therefore must be filed within thirty days of its execution with the FTC), apply its substantial equality standards, and object to the terms of the license granted by the Japanese party. However, if the FTC does overcome procedural questions and looks through the structure utilizing the two agreements, the parties are no worse off for the attempt and may proceed to amend the terms of the agreements as required.

None of the above alternatives is a complete solution for possible problems arising under the Article 6 review requirement. In most cases the parties will simply have to adjust their agreement in order to come within the FTC Guidelines as interpreted and applied at the time of review. Since that may not be a simple matter, United States counsel should, after consultation with Japanese counsel, advise his or her client of these ramifications prior to finalizing a contract, so as to mitigate and make the client aware of the possibility of objection and subsequent amendment to the agreement. Awareness of possible FTC questions on the grantback, non-competition, and quality control terms will encourage a flexible approach to these areas on the business level.

VI. Conclusion

Entering the Japanese market is a challenge to the foreign businessman and the attorney alike. For the businessman, there are such obstacles as a complex distribution system, consumer resistance, and translation questions. For the attorney there are the usual hurdles of tax, patent and trademark law, and foreign investment regulation. In addition, however, United States counsel will find ample challenge in structuring the agreement within the strictures of the Japanese Antimonopoly Law.

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47. *Gaikoku kawase kanrirei, supra* note 17.