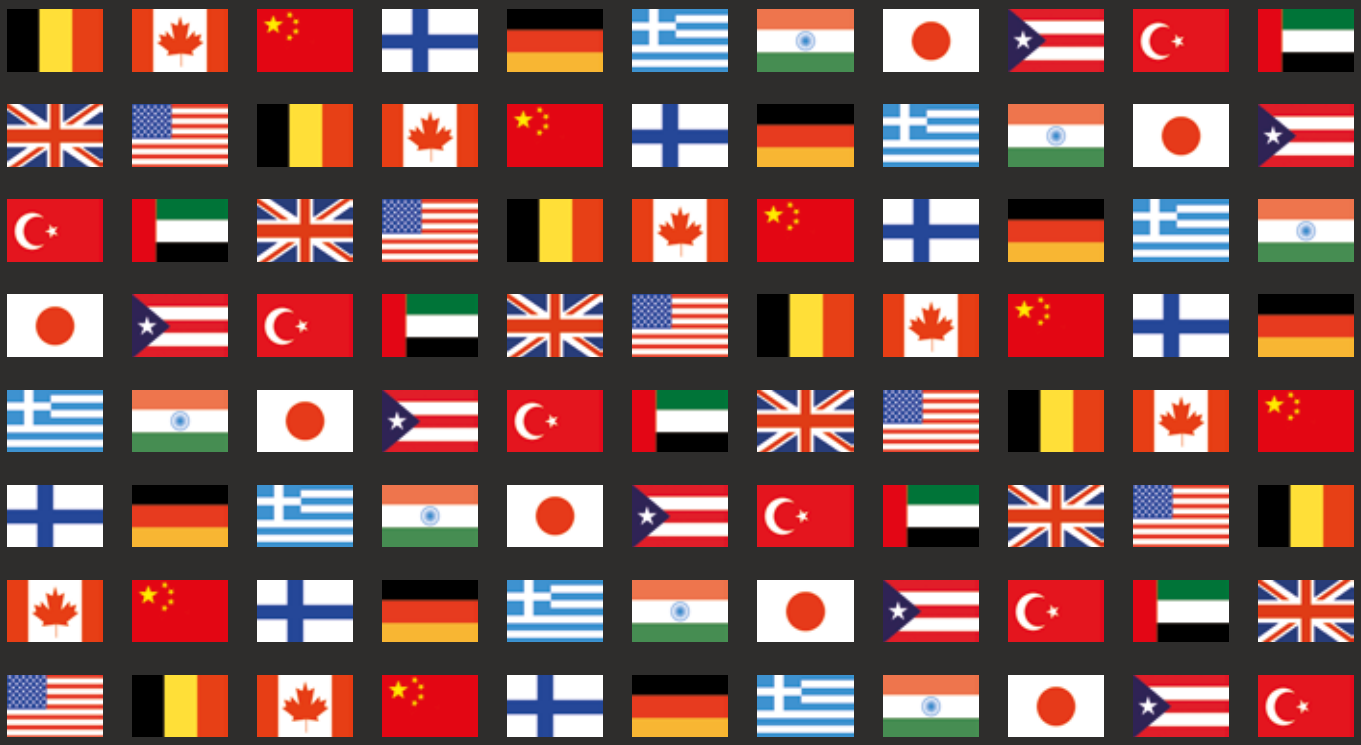
Distribution & Agency

Contributing editor
Andre R Jaglom



2019

GETTING THE DEAL THROUGH

GETTING THE DEAL THROUGH

Distribution & Agency 2019

Contributing editor

Andre R Jaglom

Tannenbaum Helpern Syracuse & Hirschtritt LLP

Reproduced with permission from Law Business Research Ltd
This article was first published inMarch 2019
For further information please contact editorial@gettingthedealthrough.com

Publisher
Tom Barnes
tom.barnes@lbresearch.com

Subscriptions
Claire Bagnall
claire.bagnall@lbresearch.com

Senior business development managers
Adam Sargent
adam.sargent@gettingthedealthrough.com

Dan White
dan.white@gettingthedealthrough.com

Law Business Research

Published by
Law Business Research Ltd
87 Lancaster Road
London, W11 1QQ, UK
Tel: +44 20 3780 4147
Fax: +44 20 7229 6910

First published 2014
Fifth edition
ISBN 978-1-83862-086-8

Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

CONTENTS

Preface

Distribution & Agency 2019

Fifth edition

Getting the Deal Through is delighted to publish the fifth edition of *Distribution & Agency*, which is available in print, as an e-book and online at www.gettingthedealthrough.com.

Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the jurisdictions featured.

Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Andre R Jaglom of Tannenbaum Helpern Syracuse & Hirschtritt LLP, for his continued assistance with this volume.

GETTING THE DEAL THROUGH

London
February 2019

Japan

Takemi Hiramatsu and Toshiyuki Kato
Nishimura & Asahi

Direct distribution

1 May a foreign supplier establish its own entity to import and distribute its products in your jurisdiction?

Generally, yes. There are two exceptions where a foreign supplier is prohibited from establishing a branch office or subsidiary in Japan: (i) where the country of the foreign supplier or the foreign supplier itself is subject to economic sanctions imposed by the Japanese government, it is necessary to obtain permission from the Minister of Finance to establish a branch office or subsidiary; and (ii) where the foreign supplier purchases shares in a Japanese corporation that conducts business in certain industries, such as broadcasting or airlines, there is a certain threshold that the foreign supplier's shareholding in such a Japanese company cannot exceed.

2 May a foreign supplier be a partial owner with a local company of the importer of its products?

Generally, yes. See question 1 for restrictions on certain industries and those under the import and export regulations of Japan.

3 What types of business entities are best suited for an importer owned by a foreign supplier? How are they formed? What laws govern them?

A foreign supplier may use a branch office or subsidiary as a business entity in Japan. A partnership is not a common business entity for a foreign supplier.

While the most traditional and common vehicle for an importer owned by a foreign supplier has been the stock company (*Kabushiki Kaisha*, 'KK'), the limited liability company (*Godo Kaisha*, 'GK') is also gaining popularity as such a vehicle. Under the Japanese Companies Act, the registration procedure for the establishment of a KK in Japan requires the following:

- drafting of the articles of incorporation;
- obtaining the registration certificates and other necessary documentation for the incorporator;preparation of affidavits regarding the incorporator's profile and affidavits regarding the signatures of the incorporator's representatives;
- notarisation of the articles of incorporation by a Japanese notary public;
- payment of the full amount of capital;
- appointment of directors. The directors must investigate the legality of the company's formation; and
- application to the Legal Affairs Bureau for registration of establishment of the company. There is a registration tax of 0.7 per cent of the amount of capital (minimum ¥150,000).

In the case of the establishment of a GK, the appointment of representative members or managing members (or both) is required instead of the appointment of directors, however, the rest of the process is similar to the establishment of a KK.

The liability of GK members, like that of shareholders in a KK, is limited to the value of a member's investment in the GK. However, compared with a KK, the housekeeping matters (corporate governance structure, commercial registration, etc) for a GK are simpler, and incorporation fees (including registration fees) are less expensive.

Moreover, a GK can be a pass-through entity under a 'check-the-box regulation' for US tax purposes.

4 Does your jurisdiction restrict foreign businesses from operating in the jurisdiction, or limit foreign investment in or ownership of domestic business entities?

Subject to those explained in question 1, there are generally no restrictions on non-resident individuals or foreign corporations from conducting business in Japan. However, if a foreign corporation continuously engages in business there, it at least needs to appoint a Japanese resident individual as its representative in Japan and have him or her registered with the competent legal affairs bureau.

5 May the foreign supplier own an equity interest in the local entity that distributes its products?

Generally, yes. See question 1.

6 What are the tax considerations for foreign suppliers and for the formation of an importer owned by a foreign supplier? What taxes are applicable to foreign businesses and individuals that operate in your jurisdiction or own interests in local businesses?

Non-resident individual

Income derived from business activities conducted by a non-resident individual will be taxable Japanese source income only, if the individual has a permanent establishment (PE) in Japan and the income is attributable to the PE.

Therefore, if a non-resident individual with no PE in Japan distributes his or her products directly to Japanese customers, the income derived from the distribution will not be taxable income for the purpose of the Japanese individual income tax.

Facilities used 'solely for the purpose of storage, display or delivery of goods' are excluded from the PE concept under most tax treaties between Japan and other countries.

However, in a case regarding a US-resident individual e-commerce distributor who distributes auto parts to Japanese customers and leases a small office and a warehouse in Japan for his or her business (*X v Japan, Gyosai Reishu* (Tokyo High Court, 28 January 2016)), a Japanese court held that the activities conducted through the office and warehouse were not 'preparatory or auxiliary' activities but established a PE in Japan under the Japan–US tax treaty. Subsequently, Japanese domestic tax law has clarified that warehouses and similar facilities are excluded from the PE concept only when they are used for 'preparatory or auxiliary' activities.

Foreign corporation

Direct distribution from overseas

Income derived from business activities conducted by a foreign corporation with no PE in Japan will not be taxable Japanese source income for the purpose of the Japanese corporation tax. A foreign corporation with no PE in Japan is not subject to local inhabitants' tax and local enterprise tax.

Branch office
If the foreign corporate distributor has a branch office in Japan, income derived from its business activities there and attributable to the branch office will be taxable Japanese source income. In such a case, the foreign corporation needs to submit an 'application form of foreign ordinary corporation' within two months of the date of establishment of the branch office, and file a tax return with the competent local tax office every year within two months of the date following the end of the foreign corporation's fiscal year.

Subsidiary
Where the distributor establishes a Japanese subsidiary to import products, the Japanese subsidiary's worldwide income (not only Japanese source income) will be taxable income for the purposes of the Japanese corporation tax, local inhabitants' tax and local enterprise tax.

On the other hand, a parent foreign supplier's income derived from selling products to its Japanese subsidiary shall not be subject to Japanese corporation tax.

If the transfer price of the products from the foreign supplier to its Japanese subsidiary is higher than the arm's-length price, the transfer price of the distribution transaction shall be deemed reduced to the arm's-length price for the Japanese corporation tax, and the Japanese subsidiary will be subject to additional Japanese corporation tax for the difference between the actual transfer price and the arm's-length price.

Distributions of retained earnings from a Japanese subsidiary to the parent foreign supplier are subject to Japanese withholding tax.

Local distributors and commercial agents

7 What distribution structures are available to a supplier?

Direct distribution
Distribution by the foreign supplier through a subsidiary or branch (see questions 1 to 6).

Commercial agents
Agents in Japan for a foreign supplier can be categorised into a 'lawful agent' who is authorised by the foreign supplier to enter into sales agreements with customers in Japan, and (a pure 'commission agent' who is not authorised to do so, but is only authorised to act as an intermediary between the foreign supplier and those customers for the former's sale of goods to the latter.

In either of these cases, an agent in Japan does not purchase or acquire title to the products, but rather sells them on the foreign supplier's behalf and receives a commission. Generally, it is the foreign supplier (rather than the agent) who owns rights and owes duties under sales contracts with customers, unless the supplier authorises or delegates the agent to exercise or perform some of them on its behalf in the agency agreement.

Independent distributors
The foreign supplier may also contract with an independent distributor that buys products from the supplier, acquiring title to those products, and resells them at a profit (ie, a margin) to its own customers. This may be the most common structure for distribution in Japan.

Franchising
Typically, franchising equates to the use of independent distributors who are licensed to use the supplier's trademarks, either in their business name or in their products, are required to follow a prescribed marketing plan or method of operation, and pay a franchise fee to the supplier. Under Japanese law, there are no specific formal requirements to create a valid and binding franchise agreement. A franchise agreement is generally considered a combination of a licence agreement and a services agreement.

However, the franchisor must provide disclosure documents before entering into a franchise agreement, if the franchise business falls under the definition of a specified chain business under the Small and Medium-sized Retail Business Promotion Act. As this Act is designed to protect small and medium-sized retail businesses, the disclosure obligations will not be imposed if the majority of the franchisees are large and sophisticated.

Joint ventures
A joint venture can be established by a foreign supplier with its distribution partner in Japan, whether the partner is an agent, distributor or franchisee, by having the local distribution entity owned in part by the supplier, directly or through a subsidiary, or through another form of sharing of profits and expenses. An ownership interest can provide greater control through ownership rights and representation on a board of directors or management committee.

Licensing of manufacturing rights
A foreign supplier may license a manufacturer in Japan to use its intellectual property, such as patent, copyright, trademark or trade secrets, to manufacture its products locally and have them sold in Japan. Care must be taken by the licensor to maintain quality control over the finished products and the licensee's use of the intellectual property. Failure to do so can not only put the brand equity at risk, but can also risk the loss of trademark protection.

Private label (original equipment manufacturer)
Distribution of products under a private label amounts to a reverse licensing arrangement, where a distributor or retailer in Japan distributes the foreign supplier's products under the Japanese distribution partner's own trademark. In essence, the supplier gives up its own brand name in exchange for the distribution strength of its partner in Japan, with the supplier reaping no enhanced brand value. Control over sales, distribution, marketing and advertising are in the hands of the local brand owner, resulting in negligible distribution costs to the supplier, and virtually no control in the hands of the supplier, save for sales and performance benchmarks in the contract, with benefits to the supplier limited to its profits on sales of the products.

8 What laws and government agencies regulate the relationship between a supplier and its distributor, agent or other representative? Are there industry self-regulatory constraints or other restrictions that may govern the distribution relationship?

Agency and distribution agreements in Japan, as contracts, are generally governed by the Civil Code. There are no special laws governing agents and distributors.

However, as you will see below, in reviewing the legality of some provisions in an agency or distribution agreement, the Antimonopoly Act and the regulations promulgated thereunder (collectively, the AM Act) (and the 'Guidelines Concerning Distribution Systems and Business Practices' issued by the Japanese Fair Trade Commission – the Guidelines) especially should be taken into account. The government agency that is primarily in charge of enforcement of the AM Act is the Japanese Fair Trade Commission (JFTC). Some industries have also adopted their commercial associations' voluntary rules concerning the above national laws and regulations.

In addition, transactions involving the movement of goods, services or capital between Japan and foreign countries concerning an international agency or distribution agreement are subject to the Foreign Exchange and Foreign Trade Act and the regulations promulgated thereunder (collectively, the FEFT Act).

9 Are there any restrictions on a supplier's right to terminate a distribution relationship without cause if permitted by contract? Is any specific cause required to terminate a distribution relationship? Do the answers differ for a decision not to renew the distribution relationship when the contract term expires?

Japanese courts, through past decisions, have established a doctrine for protecting a party to a 'continuous transaction agreement' from illegal or unlawful termination thereof by the other party (the Continuous Transaction Agreement Doctrine). An agency, distribution or franchise agreement can fall within the meaning of such a 'continuous transaction agreement' if it has continued for a certain period of time. Under the Continuous Transaction Agreement Doctrine, if a commercial agreement has lasted for a long time, such an agreement may be unilaterally terminated by one of the parties thereto only if there is either a 'justifiable reason' for the termination, or the terminating party gives reasonable notice to the other party.

The application of the Continuous Transaction Agreement Doctrine by Japanese courts is generally made, taking into account numerous factors surrounding each specific case. Such factors include the length, term and type of the agreement in question, the nature of the 'justifiable reason' asserted by the terminating party, the degree and reasonableness of the terminated party's reliance on the continuation of the agreement, and the difference in bargaining power between the parties involved. Courts also consider the length of prior notice (if any), and the amount of compensation (if offered).

The Continuous Transaction Agreement Doctrine applies regardless of whether the agreement at issue has a specific term, or whether it is terminated at the end of or in the middle of its term. However, courts generally review the legality of a termination of the agreement in the middle of its term with more scrutiny, compared to non-renewal thereof at the end of its term.

If the attempted termination of a continuous transaction agreement is deemed illegal and unlawful due to application of the Continuous Transaction Agreement Doctrine, the terminated party may (i) seek the court's declaration that the agreement remain in force, (ii) demand the terminating party's performance of the agreement, (iii) seek an injunction against the terminating party's breach of the agreement or (iv) claim for damages incurred by it due to the terminating party's breach or illegal termination of the agreement.

10 Is any mandatory compensation or indemnity required to be paid in the event of a termination without cause or otherwise?

As explained in question 9, if a party's attempted termination of an agency, distribution or franchise agreement (especially when it is attempted without cause) is deemed illegal due to application of the Continuous Transaction Agreement Doctrine, the terminating party may be required to compensate for damages incurred by the terminated party due to the illegal termination.

In such cases in the past, Japanese courts determined that the terminating party should pay, as compensation for such damages, an amount equivalent to the gross (or net) profit which the terminated party could earn for the remainder of the term of the agreement or for a period from six months to two years.

Furthermore, if the termination of a continuous transaction agreement causes other 'special loss', and if such special loss is reasonably foreseeable at the time of the termination, the terminating party would be liable for such special loss (eg, costs related to those employees of the terminated party who were exclusively engaged in the business under the continuous transaction agreement in question).

If, due to the termination of the agreement, those employees were dismissed compelling the terminated party to incur costs, such as the payment of severance in accordance with the relevant Japanese practices, and if such dismissal of the employees was reasonably foreseeable by the terminating party when it terminated the agreement, the court could determine that such loss would also be required to be compensated.

On the other hand, if a termination of a continuous transaction agreement is considered permissible despite the possible application of the Continuous Transaction Agreement Doctrine, the terminating party will in principle not be required to compensate the terminated party.

11 Will your jurisdiction enforce a distribution contract provision prohibiting the transfer of the distribution rights to the supplier's products, all or part of the ownership of the distributor or agent, or the distributor or agent's business to a third party?

Under Japanese law, contract provisions prohibiting the transfer of distribution rights to the supplier's products, all or part of the ownership of the distributor or agent, or the distributor's or agent's business to a third party, will generally be enforceable subject to the folowing.

- The supplier shall not be able to assert, as against a bona fide third party, that a transfer made by the distributor or agent violating the applicable contractual provision be void.
- The contractual provision in a distribution agreement prohibiting the distributor's assignment of the agreement may not work, as intended, to limit such assignment in the case of a corporate merger (where Corporation A and Corporation B merge into and form one Corporation A + B) or a corporate split (where Corporation A splits into two corporations: Corporation A and Corporation B). This is because the agreement will, by operation of law, be automatically assigned to the surviving corporation (in the case of a corporate merger) or the corporation that is to assume the agreement according to the relevant corporate split agreement (in the case of a corporate split).

Regulation of the distribution relationship

12 Are there limitations on the extent to which your jurisdiction will enforce confidentiality provisions in distribution agreements?

Under Japanese law, there is generally no limitation on the extent to which confidentiality provisions in distribution agreements will be enforced.

13 Are restrictions on the distribution of competing products in distribution agreements enforceable, either during the term of the relationship or afterwards?

During the term of an exclusive distribution agreement, restrictions on a distributor's handling of competing products are not illegal from the viewpoint of antitrust regulations, unless such restrictions prohibit the distributor from handling competing products it had been dealing with before the conclusion of the agreement. Where such restrictions prohibit the distributor from handling even competing products it had been dealing with before the conclusion of the agreement, the legality of such restrictions will be examined by the JFTC according to the case, taking various factors into consideration, to determine whether the restrictions have the effect of excluding competitors from the market.

Regarding the non-exclusive distribution agreement, restrictions on handling competing products during the term of the agreement are examined by the JFTC from the viewpoint of whether such restrictions are imposed by an 'influential manufacturer in a market' (defined as a manufacturer which has a market share of 10 per cent or more, or is ranked in the top three in the market) and whether they may result in making it difficult for new entrants or competitors to easily secure alternative distribution channels. If the JFTC finds such effect in the restrictions, they will be determined illegal as an unfair trade practice.

A prohibition on handling competing products after the term of a distribution agreement has expired is generally considered illegal, except where (i) that distribution agreement is exclusive, (ii) the term of such extended prohibition is less than two years after the expiry of the agreement, and (iii) there is a reasonable rationale for the prohibition, such as the necessity to protect confidential trade secrets.

14 May a supplier control the prices at which its distribution partner resells its products? If not, how are these restrictions enforced?

Under the AM Act, so far as distribution of products in the Japanese market is concerned, a supplier in principle cannot control the prices at which its distribution partner resells its products, as such resale price maintenance is illegal as an unfair trade practice.

However, under the Guidelines, the supplier's provision of its instructions regarding resale price to the distributor will not be deemed illegal in cases where the distributor, as a direct purchaser from a supplier, only functions as a commission agent for the supplier so that the supplier is substantially deemed to be selling its products to the ultimate purchasers.

15 May a supplier influence resale prices in other ways, such as suggesting resale prices, establishing a minimum advertised price policy, announcing it will not deal with customers who do not follow its pricing policy, or otherwise?

Under the AM Act (and the Guidelines), in cases where a supplier's 'suggested' retail price or quotation is indicated to its distributor as a mere reference price, it would not be a problem. However, if the supplier substantially seeks to restrict the resale price of the distributor by causing it to maintain the reference price by some means (eg, by announcing that it will not deal with distributors who do not follow its pricing policy), it will in principle be illegal.

16 May a distribution contract specify that the supplier's price to the distributor will be no higher than its lowest price to other customers?

Under Japanese law, the distribution contract may, generally, specify that the supplier's price to the distributor will be no higher than its lowest price to other customers.

17 Are there restrictions on a seller's ability to charge different prices to different customers, based on location, type of customer, quantities purchased, or otherwise?

Under the AM Act, discriminatory pricing defined as 'unjustly supplying or accepting a commodity or service at prices which discriminate between regions or between the other parties' is prohibited as an unfair trade practice. Accordingly, if there is a justifiable reason for a difference in prices, it would not be deemed illegal. However, it is generally said that in cases such as the following, a difference in prices is likely deemed to be illegal in view of its anticompetitive effect:

- where the seller sells its products at lower prices only in a territory in which the seller is competing with another seller of the same or similar products, in order to exclude the competitor from the market; or
- where the seller sells its products at lower prices only to customers of its competitor, in order to exclude the competitor from the market.

18 May a supplier restrict the geographic areas or categories of customers to which its distribution partner resells? Are exclusive territories permitted? May a supplier reserve certain customers to itself? If not, how are the limitations on such conduct enforced? Is there a distinction between active sales efforts and passive sales that are not actively solicited, and how are those terms defined?

Under the AM Act and the regulations promulgated thereunder (and the Guidelines), it is not illegal for a supplier to adopt the system for designating a geographic area of its distributor's sales responsibility or for the location of its business premises for the purpose of developing an effective network for sales or securing a system for good after-sales services, unless the restriction falls under an 'exclusive territory' (meaning a restriction on the distributor from actively selling outside the designated area) or a 'restriction on sales to outside customers' (meaning a restriction on the distributor from even passively selling to customers outside the designated area upon their request).

However, in the case where a supplier requires its exclusive distributor not to actively market the product covered by the distribution contract in areas outside the territory for which the exclusive distributor is granted the exclusive distributorship for the product, it would in principle present no problem under the AM Act.

On the other hand, even in the case of an exclusive distributorship agreement under which a supplier grants its distributor the 'exclusive' right to sell a product in a territory, it is generally possible for the parties to agree that the supplier will reserve the right to sell the product to certain customers in the territory.

19 May a supplier restrict or prohibit e-commerce sales by its distribution partners?

Under the AM Act, a supplier's restriction or prohibition on e-commerce sales by its distributor is deemed to be a kind of restriction on the distributor's sales methods. Accordingly, whether such a restriction or prohibition is illegal will be determined in accordance with what we describe in question 22.

20 Under what circumstances may a supplier refuse to deal with particular customers? May a supplier restrict its distributor's ability to deal with particular customers?

Under the AM Act (and the Guidelines), it is generally not illegal for a supplier, as a single firm, to refuse to deal with particular customers in view of the general freedom it should have in choosing which customers it will do business with, unless such a refusal to deal is made in order to secure the effectiveness of its illegal conduct under the AM Act (eg, resale price maintenance) or to achieve unjust purposes thereunder (eg, exclusion of its competitors from a market).

On the other hand, if a supplier restricts its distributor's ability to deal with certain customers, it will be illegal as an unfair trade practice if the price level of the product covered by the restriction is likely to be maintained thereby.

21 Under which circumstances might a distribution or agency agreement be deemed a reportable transaction under merger control rules and require clearance by the competition authority? What standards would be used to evaluate such a transaction?

A distribution or agency agreement per se will not be deemed a reportable transaction under Japanese merger control rules or require advance clearance by the competition authority (ie, the JFTC).

22 Do your jurisdiction's antitrust or competition laws constrain the relationship between suppliers and their distribution partners in any other ways? How are any such laws enforced and by which agencies? Can private parties bring actions under antitrust or competition laws? What remedies are available?

In the case where a supplier restricts its distributor's sales methods for the product covered by the distribution contract or causes the distributor to restrict its sub-distributors' sales methods, it may pose a problem under the AM Act unless there is a good reason for the purpose of ensuring proper sales of the product (eg, assurance of safety of the product, preservation of its qualities or maintenance of credibility of its trademark) and the same restrictions are applied to its other distributors on equal terms.

Especially in cases where restrictions on the distributor's sales methods are used a means of restricting sales price, handling of competing products or sales territory or customers, their legality is to be judged from the perspective of whether they constitute a resale price restriction, a dealing on exclusive terms or a dealing on restrictive terms that may be deemed illegal under the AM Act.

The agency in charge of enforcing the regulations under the AM Act is primarily the JFTC. When it finds that there is a violation of those regulations, it can (i) issue a warning, (ii) issue a caution, (iii) issue a cease-and-desist order, (iv) order the payment of a surcharge, or (v) seek an injunction at the Tokyo High Court.

Any (private) person who suffers damages caused by an act violating the AM Act can claim for damages based on the general theory of tort under the Civil Code or under a special provision in the AM Act. Further, under the AM Act, a person whose interests are infringed or likely to be infringed by an act constituting an unfair trade practice and who is thereby suffering or likely to suffer serious damages, is entitled to demand the suspension or prevention of such infringements from an entrepreneur or a trade association that infringes or is likely to infringe such interests.

23 Are there ways in which a distributor or agent can prevent parallel or 'grey market' imports into its territory of the supplier's products?

Under Japanese law, there is no way for a distributor or agent to legally prevent parallel or grey market imports into its territory of the supplier's products, except:

- where products being sold as parallel or grey market import goods are not genuine products but are counterfeit products;
- when it is necessary for maintaining the credibility of a trademark in the case where consumers may have been led to understand that parallel or grey market import goods with a different specification or quality are identical to the product handled by a distributor or agent due to misrepresentation of origin or other reasons; or
- when it is necessary for maintaining credibility of a trademark in the case where credibility of the product handled by a distributor or agent may be damaged due to threats to consumers' health or safety caused by deterioration of the parallel or grey market import goods.

24 What restrictions exist on the ability of a supplier or distributor to advertise and market the products it sells? May a supplier pass all or part of its cost of advertising on to its distribution partners or share in its cost of advertising?

Under the AM Act (and the Guidelines), where a distributor in a dominant bargaining position, for its own convenience, causes the supplier

to pay monetary contributions or inflict other financial burdens for the cost of advertising, it is most likely to unjustly favour the distributor and present a problem as an abuse of dominant bargaining position.

On the other hand, a supplier may generally pass all or part of its cost of advertising on to its distribution partner or share in its cost of advertising, by agreement to that effect with its distribution partner.

25 How may a supplier safeguard its intellectual property from infringement by its distribution partners and by third parties? Are technology-transfer agreements common?

Trademarks

Trademarks are generally protected only upon registrations through the Japan Patent Office (JPO). Japanese trademark registration can also be obtained under the Madrid Protocol, if the supplier's home country is a signatory to the treaty.

Only the owner of a trademark may obtain a Japanese registration. Accordingly, in general, the supplier, rather than the local distributor, will be the applicant. Contracts typically forbid the distributor from registering the trademark, in order to protect the supplier from infringement by its distribution partner. Some contracts allow the distribution partner to register itself as a licensee of the trademarks in Japan, but it is risky for the supplier. Especially so if the distribution partner is registered as the exclusive licensee of the trademarks in Japan, when even the supplier cannot use its own trademarks there unless the registration of the distribution partner as such is abolished, resulting in the greater bargaining power of the distribution partner when the supplier attempts to terminate the distribution agreement.

Patents and utility models

Patents and utility models are generally protected upon registrations through the JPO. Japanese patent and utility model registration can also be obtained under the Patent Cooperation Treaty, if the supplier's home country is a signatory to the treaty.

The distribution partner's unauthorised sale of products protected by a patent or utility model is usually regulated by contract, but can also be remedied through an infringement suit.

Registered designs

Under Japanese law, designs can also be protected upon registrations through the JPO.

The distribution partner's unauthorised sale of products protected by a registered design is usually regulated by contract, but can also be remedied through an infringement suit.

Copyright

The copyright in a copyrightable work is protected without registration from the moment the work is created. While the copyright as an economic right is transferable (and the transfer can be asserted against a third party upon registration), the moral right in a copyrightable work is not transferable.

The distribution partner's unauthorised use of materials protected by copyright is usually regulated by contract, but can also be remedied through an infringement suit.

Trade secrets and know-how

The supplier's trade secrets and know-how are generally protected in accordance with confidentiality provisions in the distribution agreement.

In addition, the Unfair Competition Prevention Act (UCPA) provides for some 'act of unfair competition' categories regarding misuse or improper disclosure of trade secrets. A trade secret is protected under the UCPA if it consists of technical or business information that is useful for commercial activities, and it is kept secret and not publicly known. Remedies for such an act of unfair competition are an injunction and compensation for damages.

Technology-transfer agreements

Technology-transfer agreements are not commonly used to structure the relationships between commercial suppliers and their distribution partners, where a licence agreement is more common.

26 What consumer protection laws are relevant to a supplier or distributor?

Under Japanese law, so long as neither the supplier nor its distributor is an individual, no consumer protection law will apply to regulate the relationship between them.

However, inasmuch as the products to be supplied by the supplier to its distributor for distribution in Japan are sold to general consumers, consumer protection laws may apply to the sales or the products sold. Such laws include the Product Liability Act, the Consumer Product Safety Act and the Consumer Contract Act, in addition to the statutory warranty and other relevant provisions in the Civil Code. The Act Against Unjustifiable Premiums and Misleading Representations may also apply to regulate the contents of the supplier's and distributor's advertisements.

27 Briefly describe any legal requirements regarding recalls of distributed products. May the distribution agreement delineate which party is responsible for carrying out and absorbing the cost of a recall?

Under the Consumer Product Safety Act, in cases where 'serious product accidents' have occurred due to a defect in the consumer products or where serious danger has occurred to the lives or safety of general consumers or the occurrence of such danger is considered to be imminent, when the competent minister finds it particularly necessary to prevent the occurrence of and increase in this danger, to the extent necessary the minister may generally order the person engaging in the manufacture or import of the consumer products to recall the products in question and otherwise take measures necessary to prevent the occurrence of and increase in serious danger to the lives or safety of general consumers due to the products. (In addition, a 'voluntary' recall may be made by the manufacturer or importer.)

It is prudent to define in the distribution contract the parties' respective responsibilities in the event of a recall, including who may decide to initiate a recall, how it will be implemented, and who will pay the costs, including credit that customers may require for recalled products. Without such defining provisions in the contract, it is likely under Japanese law that the supplier (rather than the distributor) will eventually be responsible for all of the costs reasonably required to be incurred for a recall.

28 To what extent may a supplier limit the warranties it provides to its distribution partners and to what extent can both limit the warranties provided to their downstream customers?

Under Japanese law, so long as neither the supplier nor its distributor is an individual, any limitations on the supplier's warranties to be provided to its distribution partner will generally be valid and effective, except that the supplier cannot deny its liability for a loss of a person's life or his or her bodily injury or its liability for damages caused by its intentional act, for reasons of Japanese public policy.

However, inasmuch as the products to be supplied by the supplier to its distributor for distribution in Japan are sold to general consumers, certain provisions in the sales agreements limiting the seller's warranties provided to general consumers may be deemed void under the applicable provisions in the Consumer Contract Act.

29 Are there restrictions on the exchange of information between a supplier and its distribution partners about the customers and end users of their products? Who owns such information and what data protection or privacy regulations are applicable?

Companies collecting personal information regarding individual customers must generally describe, as specifically as possible, the purposes of their use of personal information to be collected from them; and they cannot exceed the scope of such purposes of use or transfer the personal information to any third party without the prior consent of the relevant individual customers, except in certain prescribed circumstances. Particularly in the case where a Japanese company intends to transfer such personal information to a third party located in a country other than Japan, prescribed circumstances available as exceptions to the general rule (requiring the prior consent of the relevant individual customers) are more limited than in the case where such a third party transferee is located in Japan. In addition, when a Japanese company

discloses such personal information to, or receives it from, a third party, whether located in Japan or in a country other than Japan, the Japanese company must generally make a record of certain items designated by statute (eg, the name of the third party) that are relevant to such disclosure or receipt of the personal information and keep such record for a prescribed period of one to three years, depending upon the type of record, except in certain prescribed circumstances. Within those constraints, and subject to any specifically regulated areas (and further subject to any applicable regulations of a foreign country), the distribution partner may generally exchange its customer information with the supplier.

Parties should clearly define in their distribution contract who will own the customer information that will be collected, who will have access to it, and the applicable confidentiality obligations to be respectively owed by them. In the absence of such a definition, customer information is likely to belong to the party that collected it and any transfer thereof by that party to the other party will be subject to applicable data protection or privacy regulations.

30 May a supplier approve or reject the individuals who manage the distribution partner's business, or terminate the relationship if not satisfied with the management?

Under the general principle of freedom of contract that is recognised under Japanese law, the parties may generally provide as they wish with respect to the supplier's control over those who manage the distributor. Accordingly, the distribution contract can grant authority to a supplier to approve or reject the individuals who manage the distribution partner's business, or to terminate the contract if not satisfied with the management.

31 Are there circumstances under which a distributor or agent would be treated as an employee of the supplier, and what are the consequences of such treatment? How can a supplier protect against responsibility for potential violations of labour and employment laws by its distribution partners?

Under Japanese law, a distributor cannot be treated as an employee of the supplier.

On the other hand, an agent, especially when it is an individual or a single-employee company or sole proprietorship, might be deemed an employee of the supplier. The principal test for distinguishing an independent contractor from an employee is whether the supplier allows the agent their own discretion in performing their services rather than having them perform their services under the complete direction and supervision of the supplier. Misclassification may result in substantial employment and tax liabilities for the supplier, including retroactive pay and benefits. Employees are generally entitled, among other benefits, to minimum wage and overtime compensation, unemployment benefits, and workers' compensation.

The supplier should include a provision for indemnification in its contract with the distribution partner, in order to protect itself against any responsibility for potential violations of labour and employment laws by its distribution partner.

32 Is the payment of commission to a commercial agent regulated?

Under Japanese law, there are generally no regulations on the payment of commission to a commercial agent.

33 What good faith and fair dealing requirements apply to distribution relationships?

There is a general principle requiring good faith and fair dealing from parties to a contract when they perform it. This general principle may apply to the parties to a distribution contract. In particular, the Continuous Transaction Agreement Doctrine referred to in question 9 can be interpreted as being based on this general principle of law.

34 Are there laws requiring that distribution agreements or intellectual property licence agreements be registered with or approved by any government agency?

There is no legal requirement for the registration of a distribution agreement with any Japanese governmental agency.

On the other hand, under the FEFT Act, there is a filing requirement for an agreement under which industrial property or know-how is licensed by a foreign licensor to a Japanese licensee. However, this requirement applies only when the licensed industrial property or know-how relates to any of the following five designated categories: (i) aircraft; (ii) weapons; (iii) manufacture of explosives; (iv) nuclear power; or (v) development in outer space. If the licensed industrial property or know-how falls under any of the above-designated categories, a prior notification on conclusion of the licence agreement must generally be filed with the competent ministers through the Bank of Japan unless the amount of consideration for the licence is ¥100 million or less (in which case, an ex post facto report will suffice). Accordingly, a foreign supplier's grant to its distribution partner of the right to use a trademark, made with regard to a distribution right for Japan, will generally not be subject to the filing requirement as we cannot think of a situation where such a trademark falls under any of the above-designated categories.

35 To what extent are anti-bribery or anti-corruption laws applicable to relationships between suppliers and their distribution partners?

Japanese law encompasses certain anti-bribery and anti-corruption regulations. Most notable for an international distribution relationship are the provisions under the UCPA that address bribery of foreign public officials. The UCPA applies to (i) an individual of any nationality, if all or part of the violating act is committed in Japan, and (ii) a Japanese national who offers a bribe to any foreign official regardless of where the conduct occurs. The UCPA may also apply to an entity whose representative, agent or employee has engaged in the above types of conduct.

Of course, a foreign supplier should be cautious about any risks related to any possible misconduct by its distribution partner in Japan, to which not only the anti-bribery or anti-corruption law of Japan, but also that of a foreign country, may apply.

36 Are there any other restrictions on provisions in distribution contracts or limitations on their enforceability? Are there any mandatory provisions? Are there any provisions that local law will deem included even if absent?

Except for the specific industry or franchise regulations and the restrictions under the AM Act (as discussed above), the parties are generally free to structure their distribution relationship as they desire.

Governing law and choice of forum

37 Are there restrictions on the parties' contractual choice of a country's law to govern a distribution contract?

Japanese courts will generally recognise the parties' contractual choice of law to govern a distribution contract.

However, when the distribution contract is concluded for the purpose of distribution in the Japanese market, there are certain mandatory local regulations that apply to a distribution agreement, despite the parties' contractual choice of a foreign law. Such mandatory local regulations include those under the AM Act and the Continuous Transaction Agreement Doctrine established by judicial precedents that may apply to an attempted termination of the distribution contract (see questions 9 and 10). In this connection, the Guidelines include a section entitled 'Major Restrictive Provisions in Exclusive Distributorship Contracts'.

In addition, it should be noted that since Japan is a signatory to the United Nations Convention on Contracts for the International Sale of Goods (1980), the provisions of an international distribution contract to be concluded by a Japanese party may be superseded by those of the Convention, unless the contract contains the parties' agreement to exclude the application of the Convention.

38 Are there restrictions on the parties' contractual choice of courts or arbitration tribunals, whether within or outside your jurisdiction, to resolve contractual disputes?

Japanese courts will generally recognise the parties' contractual choice of courts or arbitration tribunals, whether inside or outside Japan, to resolve contractual disputes.

39 What courts, procedures and remedies are available to suppliers and distribution partners to resolve disputes? Are foreign businesses restricted in their ability to make use of these courts and procedures? Can they expect fair treatment? To what extent can a litigant require disclosure of documents or testimony from an adverse party? What are the advantages and disadvantages to a foreign business of resolving disputes in your country's courts?

When a dispute arising under an international distribution agreement is brought before a Japanese court, it will be presided over by a regular court so long as the court has jurisdiction over the dispute, and the legal action will proceed in accordance with the Code of Civil Procedures and the regulations promulgated thereunder. In such a legal action, a Japanese court may issue a decision ordering the losing party to pay monetary compensation for damages incurred by the winning party or declaring restoration of the contract based on the grounds that attempted termination thereof should be deemed void.

Even foreign businesses are not restricted in their ability to make use of a Japanese court and the procedures for a legal action before such a court, so long as it has jurisdiction over the relevant dispute; and they can generally expect fair treatment by a Japanese court.

Under Japanese civil procedure law, no extensive 'discovery' system which allows one party to request that another party disclose and produce documents and other materials outside the proceedings before the court, is in place for a legal action before a Japanese court. What is available instead is the more limited scope of a court order to produce documents and other materials that may be issued upon a party's request made through the proceedings before the court. The system of 'deposition' to be made by a party outside the court is also not in place for a legal action in Japan. Testimony from an adverse party will only be given in the trial before the court, after the court admits a party's request for such a testimony.

The advantages to a foreign business of resolving a dispute in Japan in a legal action before a court may include (i) less likelihood that a Japanese court would deny its jurisdiction over the legal action brought against a Japanese party; (ii) no need to prove Japanese law when it is the law governing the dispute; and (iii) the ease in enforcing the Japanese court's judgment to be rendered in favour of the foreign business by a court's order of attachment to an asset of the Japanese party located in Japan. On the other hand, the disadvantages may include (i) costs associated with the action (including translation costs, as the legal proceedings and submission of a document therein, in principle, need to be carried out or made in Japanese), and (ii) the foreign business's unfamiliarity with the Japanese system.

40 Will an agreement to mediate or arbitrate disputes be enforced in your jurisdiction? Are there any limitations on the terms of an agreement to arbitrate? What are the advantages and disadvantages for a foreign business of resolving disputes by arbitration in a dispute with a business partner in your country?

Under Japanese law, the parties' agreement to arbitrate disputes arising under a contract will generally be effective and enforceable. There is no particular limitation on the terms of their agreement to arbitrate, so long as they are consistent with the arbitration rules (such as those established by an arbitration association) chosen by them to apply to an arbitration for such disputes.

The advantages to a foreign business of resolving a dispute with its business partner in Japan by arbitration may include (i) the principle that once a final award is rendered by the arbitrator(s), it will become final and binding without the need to go through any appellate proceedings, resulting in less time until the dispute is resolved; (ii) the principle that the arbitration proceedings will not need to be carried out in a manner open to the public, which may be more suitable depending upon the subject of the dispute and the need to avoid the dispute negatively affecting the party or parties in public; (iii) the flexibility in defining some practical rules for arbitration; and (iv) the relative ease in enforcing in Japan an arbitration award to be rendered in favour of the foreign business, due to the fact that Japan is a signatory to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958) (the New York Convention). On the other hand, the disadvantages may include (i) costs associated with arbitration (including fees for arbitrator(s) that may be substantial), and (ii) potential difficulty in finding good arbitrator(s) suitable for and capable of resolving the dispute, using the language selected by the parties for the arbitration.

NISHIMURA & ASAHI

Takemi Hiramatsu **t_hiramatsu@jurists.co.jp**
Toshiyuki Kato **t_kato@jurists.co.jp**

Otemon Tower
1-1-2 Otemachi
Chiyoda-ku
Tokyo 100-8124
Japan

Tel: +81 3 6250 6200
Fax: +81 3 6250 7200
www.jurists.co.jp/en

Getting the Deal Through

Acquisition Finance
Advertising & Marketing
Agribusiness
Air Transport
Anti-Corruption Regulation
Anti-Money Laundering
Appeals
Arbitration
Art Law
Asset Recovery
Automotive
Aviation Finance & Leasing
Aviation Liability
Banking Regulation
Cartel Regulation
Class Actions
Cloud Computing
Commercial Contracts
Competition Compliance
Complex Commercial Litigation
Construction
Copyright
Corporate Governance
Corporate Immigration
Corporate Reorganisations
Cybersecurity
Data Protection & Privacy
Debt Capital Markets
Defence & Security Procurement
Dispute Resolution
Distribution & Agency
Domains & Domain Names
Dominance
e-Commerce
Electricity Regulation
Energy Disputes
Enforcement of Foreign Judgments
Environment & Climate Regulation
Equity Derivatives
Executive Compensation & Employee Benefits
Financial Services Compliance
Financial Services Litigation
Fintech
Foreign Investment Review
Franchise
Fund Management
Gaming
Gas Regulation
Government Investigations
Government Relations
Healthcare Enforcement & Litigation
High-Yield Debt
Initial Public Offerings
Insurance & Reinsurance
Insurance Litigation
Intellectual Property & Antitrust
Investment Treaty Arbitration
Islamic Finance & Markets
Joint Ventures
Labour & Employment
Legal Privilege & Professional Secrecy
Licensing
Life Sciences
Litigation Funding
Loans & Secured Financing
M&A Litigation
Mediation
Merger Control
Mining
Oil Regulation
Patents
Pensions & Retirement Plans
Pharmaceutical Antitrust
Ports & Terminals
Private Antitrust Litigation
Private Banking & Wealth Management
Private Client
Private Equity
Private M&A
Product Liability
Product Recall
Project Finance
Public M&A
Public Procurement
Public-Private Partnerships
Rail Transport
Real Estate
Real Estate M&A
Renewable Energy
Restructuring & Insolvency
Right of Publicity
Risk & Compliance Management
Securities Finance
Securities Litigation
Shareholder Activism & Engagement
Ship Finance
Shipbuilding
Shipping
Sovereign Immunity
Sports Law
State Aid
Structured Finance & Securitisation
Tax Controversy
Tax on Inbound Investment
Technology M&A
Telecoms & Media
Trade & Customs
Trademarks
Transfer Pricing
Vertical Agreements

Also available digitally

Online

www.gettingthedealthrough.com

ISBN 978-1-83862-086-8