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BLOG

Beware of Business Collaborations with Startups in Japan: New Guidelines Released

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As part of an ongoing effort by the Japanese government to promote economic growth through open innovation, late last year, the Japan Fair Trade Commission (JFTC) and Ministry of Economy, Trade and Industry (METI) jointly released draft Guidelines on Business Collaborations with Startups (the Guidelines).[1] The Guidelines seek to facilitate successful innovation through business collaborations while preventing unfair situations that can arise from the unequal bargaining power between large corporations and startups. This post outlines both the examples and the relevant competition law issues that the Guidelines detail, and discusses key legal risks surrounding transactions with startups in Japan.

Background

Collaborations between large corporations and startups are generally considered beneficial for promoting innovation. However, some Japanese startups have complained that in collaborating with large corporations, they have been forced to accept one-sided terms and denied intellectual-property rights deriving from their joint research. In response to these complaints, the JFTC surveyed business practices between large corporations and startups. In November 2020, it released a survey report detailing what are called “problematic situations” and potential violations of Japan’s antitrust law, the Antimonopoly Act (AMA).[2] According to the survey responses from startups, the JFTC and METI jointly drafted the Guidelines to highlight the competition law issues underlying these potentially problematic situations and present possible solutions to eliminate such situations.[3]

The Guidelines focus on the following four types of agreements common in these business collaborations: (1) nondisclosure agreements (NDAs); (2) proof of concept (POC) agreements[4]; (3) joint research agreements; and (4) license agreements. The Guidelines provide actual examples of problematic situations that startups have reported, underlying competition law issues, and improvement proposals to prevent such situations, as outlined below.

Case Studies from Guidelines

The table below summarizes the situations covered by the Guidelines in which a large corporation has been accused of requesting or imposing unfavorable terms on a startup.

1. NDA

[Case 1-1] Request to disclose a trade secret without an NDA

[Case 1-2] One-sided confidentiality or disclosure obligations

[Case 1-3] Misappropriation of a trade secret in violation of an NDA

2. POC

[Case 2-1] No additional compensation for conducting or redoing the POC

3. Joint Research

[Case 3-1] Request to vest IP rights from joint research to only one party

[Case 3-2] “Joint” research in name only – most research done by startup, but achievements unfairly distributed

[Case 3-3] Restriction on customers selling goods or services developed from joint research

4. Licensing

[Case 4-1] Request for free license

[Case 4-2] Restriction on patent applications for technologies developed by a startup and licensed to a collaboration partner

[Case 4-3] Restriction on customers selling goods or services related to licensing

4. Misc.

[Case 5-1] Request to disclose customer information

[Case 5-2] Unreasonable payment reduction or delay

[Case 5-3] Request for startup to assume all liability for damages accruing from goods and services developed through business collaborations

[Case 5-4] Restriction on customers and suppliers apart from joint research or licensing

[Case 5-5] Most-favored-nation clause for a collaboration partner

The Guidelines analyze the background of these cases and speculate that the following three factors contribute to these situations, which are detrimental to startups:

- Many startups lack legal staff and experience and thus have only a superficial understanding of the contract terms proposed by larger businesses with which they collaborate;
- One or both parties to a collaboration fail to set goals that encourage open innovation, such as maximizing mutual profits; and
- Large corporations take advantage of vulnerable startups by making excessive requests or demands.

The Guidelines include proposals to prevent each situation above; for example, by suggesting that startups use external experts to negotiate on equal footing and that parties sufficiently discuss and understand each other's needs and reflect them in the concrete terms of their collaboration.

Competition Law Issues

The Guidelines analyze each of the cases described above from the point of view of competition law, highlighting potential issues with (i) abuse of a superior bargaining position and (ii) unlawful vertical restraints.[5] Below, we define these concepts as they are used in the Antimonopoly Act, describe their application in the context of transactions with startups, and provide practical tips to mitigate risk.

1. Abuse of Superior Bargaining Position

The Guidelines categorize imposition of economic disadvantages on startups in various forms—unilateral disclosure of business secrets (Cases 1-1 and 1-2), POC without pay (Case 2-1), unfair distribution of achievements from the joint research (Cases 3-1 and 3-2), free licensing and restriction on licensed technologies (Cases 4-1 and 4-2), and other unfair requests (Cases 5-1, 5-2, and 5-3)—as situations involving abuse of a superior bargaining position. The AMA prohibits companies from taking advantage of their superior bargaining positions to impose economically disadvantageous terms on their trading partners.[6] The violation is subject to a cease-and-desist order[7] and a surcharge-payment order.[8] Unlike U.S. antitrust law, which does not restrict negotiations between transacting parties on unequal footing, Japan implemented this regulation years ago to promote fair competition and protect small- and medium-sized enterprises. The JFTC's application of the prohibition to the consumer-protection sphere—to help consumers whose personal information is acquired and used by digital-platform providers[9]—is a recent example of this trend to reframe the regulation to fit a modern context. The JFTC is now giving this regulation another new role—to protect startups.

Hypothetical: Party A requests that Party B do something substantially disadvantageous for Party B, and Party B has no choice but to accept the request because refusing would make it difficult to continue the transaction and thereby impede Party B's business. Under this scenario, Party A is in a superior bargaining position over Party B.[10] The economic disadvantage may take many forms but can be grouped into either of two categories: (1) unforeseeable circumstances that were not contemplated by the contract or (2) an agreed-upon outcome, but at an excessive cost that was not anticipated by the contract.[11]

The Guidelines explain that a large corporation could abuse its superior bargaining position in a transaction with a startup if it requests terms disadvantageous to the startup that the startup has no choice but to accept, out of fear that rejecting such terms would have a detrimental impact on its future transactions, such as ending the business collaboration. The Guidelines further state that even at the outset of a transaction—such as when executing an NDA—a large corporation could abuse its superior bargaining position over a startup that it has never transacted with if the startup is developing business in a challenging field where the market demand has not yet become apparent and thus would find it difficult to switch business partners. Accordingly, in such situations, a large corporation could unknowingly breach this regulation because of the startup's business environment, which is not always known to the large corporation.

2. Unlawful Vertical Restraint

The Guidelines state that where a large buyer or user restrains the trading terms of a startup's products that come from joint research (Case 3-3), products licensed by a startup (Case 4-3), or products related to neither joint research nor license (Case 5-4) or imposes most-favored-nation-clause (Case 5-5) regulations against unlawful vertical restraints come into play. The AMA regulates this type of restriction as an unfair trade practice, and the violation is subject to a cease-and-desist order.[12] The Guidelines confirm that vertical restraints, like those shown in these cases, may be unlawful when imposed by an influential enterprise in a market[13] if they could impede fair competition without any reasonable justification, such as to protect the enterprise's expertise or data provided to the startup to develop the product.

Practice Tips

The problematic situations discussed in the Guidelines could be subject to investigation by the JFTC as violations of the competition law. And the Guidelines make clear that the JFTC is likely to find abuse of superior bargaining position or unlawful vertical restraints in cases where a large corporation imposes one-sided terms on a startup. To avoid potential violations, large corporations should carefully examine their own business practices in their dealings with startups, especially in the following respects:

Abuse of Superior Bargaining Position

- Take time to negotiate contractual terms. Skipping discussions about contract terms and jumping into agreements could be risky if the startup later complains about the agreed-upon terms.
- Even if a startup proactively makes a generous offer, such as offering to disclose its expertise for free, keep a record of the negotiation process.

Unlawful Vertical Restraint

- Ensure that the terms of agreements with startups are appropriately tailored to protect the large corporation's expertise or products, and make sure to document the business justifications for the terms.
- Examine the potential negative impact on competition that the terms could cause.

Conclusion

Several organizations composed of large companies submitted public comments to the Guidelines expressing concern that the Guidelines do not adequately reflect the position of larger companies. Specifically, they argue that

while the Guidelines do identify examples of potential violations and harm to startups, they do not clarify, as currently drafted, the boundaries of permissible conduct because they fail to provide specific criteria for assessing when certain dealings are unlawful. Indeed, one-sided agreements may be inevitable in certain circumstances, because it is not the role of parties entering into a transaction to teach and guide their inexperienced trading partners. Moreover, some startups intentionally decide not to push back on apparently disadvantageous terms because they prioritize other factors as they seek successful collaborations. As such, large corporations need clear-cut guidance to avoid potential violations. We will keep a close eye on whether and how the JFTC and METI will respond to public comments or address the concerns of the larger corporations.

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[1] The Guidelines are available in Japanese at https://www.meti.go.jp/press/2020/12/20201223005/20201223005-2.pdf. The Guidelines were released on December 23, 2020, and public comments were solicited through January 25, 2021. A final version of the Guidelines will be published in the future, though the date is not yet set.

[2] *See* Japan Fair Trade Comm'n, "スタートアップの取引慣行に関する実態調査について(最終報告)" [Survey on Startup's Business Practices (Final Report)] (Nov. 27, 2020), available in Japanese at https://www.jftc.go.jp/houdou/pressrelease/2020/nov/201127pressrelease_1.pdf. The survey defines a startup as an unlisted company established within the past ten years that conducts innovative business in a growing industry. Although the Guidelines do not define a startup, this survey definition could help companies interpret the Guidelines.

[3] The JFTC drafted the sections of the Guidelines covering problematic situations and underlying competition law issues, and METI drafted the proposals for improving the situations.

[4] Proof of concept is a demonstration of a design concept or business proposal through an experiment or a pilot project to verify its feasibility. If it is successful, a startup and a collaboration partner could move to joint research for further development.

[5] The Guidelines note that in Case 1-3 (violation of an NDA), if a large corporation misappropriates business secrets from a startup in violation of an NDA and sells competing products to the startup's customers, thereby impeding the transactions between the startup and its customers, this could violate article 14 ("Interference with a Competitor's Transactions") of Designation of Unfair Trade Practices, Fair Trade Commission Public Notice No. 15 of June 18, 1982. The large corporation could receive a cease-and-desist order set forth in article 20 of the AMA.

[6] AMA, art. 2, ¶ 9, subparagraph 5.

[7] AMA, art. 20.

[8] AMA, art. 20-6.

[9] *See* Japan Fair Trade Comm'n, "Guidelines Concerning Abuse of a Superior Bargaining Position in Transactions between Digital Platform Operators and Consumers that Provide Personal Information, etc." (Dec. 17, 2019), available in English as a tentative translation at https://www.jftc.go.jp/en/legislation_gls/imonopoly_guidelines_files/191217DPconsumerGL.pdf.

[10] Party A does not need to have a market-dominant position. *See* Japan Fair Trade Comm'n, "Guidelines Concerning Abuse of Superior Bargaining Position under the Antimonopoly Act" (Nov. 30, 2010) at 5, available in English as a tentative translation at https://www.jftc.go.jp/en/legislation_gls/imonopoly_guidelines_files/101130GL.pdf.

[11] Tadashi Shiraishi, “The Exploitative Abuse Prohibition: Activated by Modern Issues,” Antitrust Bulletin 62, no. 4 (Dec. 2017) at 747. In other words, there is no “abuse of a superior bargaining position” where the circumstances reflect what the parties have properly agreed in the contract.

[12] AMA, art. 20; Designation of Unfair Trade Practices, arts. 11, 12, Fair Trade Comm’n Public Notice No. 15 of June 18, 1982. The violation is not subject to a surcharge-payment order.

[13] To judge illegality of the vertical restraints, the Guidelines refer to those outlined by prior JFTC “Guidelines concerning Distribution Systems and Business Practices under the Antimonopoly Act,” the tentative translation of which is available at https://www.jftc.go.jp/en/legislation_gls/210122.pdf. The “influential enterprise in a market” is also defined therein.

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