NAGASHIMA OHNO & TSUNEMATSU
長島·大野·常松 法律事務所

NO&T Japan Legal Update

September, 2022 No.36

This issue covers the following topics:

ANTITRUST AND COMPETITION

Changes to rating algorithms used by online platform business operators may violate the Antimonopoly Act

I. Introduction

On June 16, 2022, the Tokyo District Court held that "Kakaku.com", the operator of an online restaurant review and search platform, had abused its superior bargaining position and violated the Antimonopoly Act by improperly changing its restaurant rating algorithm.

This article provides an overview of the ruling and discussion of the key factors that led the Court to determine when changes to an algorithm would constitute a violation of the Antimonopoly Act. The case provides a useful guideline for platform business operators contemplating changes to their algorithms.

Please note that the content of this article is based on media coverage, commentary and other public sources since the text of the ruling has not yet been made public.

II. Case Summary

Kakaku.com operates the online restaurant review and search platform, "Tabelog", where customers can search for restaurants using various criteria, including location, type of cuisine and price range. In addition , customers are able to register and leave reviews and ratings. Restaurants are also able to register their business on Tabelog for free. For additional fees, restaurants are provided with access to extra tools to enhance their restaurant's profile and reach a larger audience. Restaurants that pay the certain additional fee are also preferentially placed in user search results. Tabelog is one of Japan's largest and most well-known online restaurant review and search platforms with approximately 830,000 restaurants listed and a reported

© 2022 Nagashima Ohno & Tsunematsu

93 million users per month as of June 2022[1].

Hanryu-mura, a chain of BBQ restaurants, filed a lawsuit claiming that Kakaku.com changed the algorithm used to calculate restaurant ratings in May 2019, which resulted in the ratings of Hanryu-mura's restaurants decreasing.

Hanryu-mura claimed that Kakaku.com secretly altered the algorithm to lower the ratings of chain restaurants to induce the company to pay higher fees to make their restaurants display at a higher position in search results. Hanryu-mura sought an injunction against the use of the changed algorithm and JPY 639 million in damages.

Although the circumstances are yet unclear, it was reported that Kakaku.com disclosed its algorithm to Hanryu-mura as part of the court proceedings. This is an uncommon occurrence as algorithms are generally considered to be highly confidential information and disclosure is usually fiercely contested.

The Tokyo District Court dismissed the plaintiff's request for injunction against the use of the changed algorithm but awarded the plaintiff JPY 38.4 million in damages after ruling that Kakaku.com's change to the algorithm constituted the abuse of its superior bargaining position.

III. Abuse of a Superior Bargaining Position

(1) Superior bargaining position

Under the Antimonopoly Act in Japan, it is prohibited for a business operator (Party A) to abuse a superior bargaining position relative to another party (Party B) by disadvantageously setting or changing the terms of a transaction or implementing a transaction that impedes fair competition. Unlike the prohibition of abuse of a dominant position in the EU, it is not necessary for Party A to have a dominant market position; rather, it is sufficient for Party A to merely have a relatively superior bargaining position as compared to Party B.

In this case, the Court found that Kakaku.com had a superior bargaining position stating that Hanryu-mura had no choice but to accept even disadvantageous requests from Kakaku.com because it would otherwise face a major problem in the management of its restaurants if the restaurants could not continue to be paid members of Tabelog. This finding may not be so surprising given the important role that Tabelog plays in the restaurant industry in Japan.

(2) Implementation of a transaction

One key issue in this case was whether the change to the rating algorithm constituted the disadvantageous "implementation of a transaction" by Kakaku.com. Although restaurants can become paid members of Tabelog, the ratings of each restaurant are not part of the terms and conditions of that paid membership. Tabelog displays the ratings of not only paid members but also free members and even non-member restaurants that have no business relationship with Kakaku.com, and the ratings do not rise or fall depending on whether the restaurant is a paid member or not. Kakaku.com argued that the act of assigning a score to a restaurant did not constitute a "transaction."

On this issue, the Japan Fair Trade Commission (the "**JFTC**") submitted an amicus brief in response to the Court's request. The amicus brief states that, although the rating on Tabelog is not a part of the contract with paid members or free members, it is a service provided in connection with a transaction and constitutes at least the "implementation of a transaction." The JFTC gave the following reasons:

(i) The score on Tabelog is an indicator that shows how many evaluations have been gathered from users at that time for the restaurant;

[1] https://owner.tabelog.com/owner_info

© 2022 Nagashima Ohno & Tsunematsu

(ii) Restaurants can become a paid member of Tabelog to update their information and increase their exposure to consumers through "profile registration" and "access enhancement" in order to attract more customers; and

(iii) The restaurant's rating is increased by increasing the number of users' evaluations and reviews, thereby attracting more customers.

However, since the text of the ruling has not been made public, it is not clear on what grounds the Court found that the change to the algorithm constituted the disadvantageous implementation of a transaction.

(3) Impediment to fair competition

The other issue in the case was whether the change to the algorithm constituted an impediment to fair competition. The JFTC's amicus brief stated that the following factors should be considered when determining whether the establishment and operation of the algorithm in question impedes fair competition:

(i) the overall content of the algorithm applied to restaurant ratings and the circumstances of the changes (e.g., what factors are taken into account, how often the factors are reviewed and changed);

(ii) in what manner, when, and for what range of restaurants is the algorithm set and operated (including whether or not there is prior consultation with the restaurants);

(iii) whether the algorithm is of a nature to suppress the restaurants' autonomy; and

(iv) the extent to which the algorithm is detrimental to the restaurants.

In reaching its decision, the Court may have concluded that the change of the algorithm in question impeded fair competition based on the JFTC's criteria above.

IV. Conclusion

This ruling is particularly noteworthy in that it shows that an unfair algorithm change could constitute a violation of the Antimonopoly Act, and disclosure of the algorithm may be required as part of court proceedings. Platform operators need to take careful consideration of all the factors set forth by the JFTC when changing their rating algorithm including, the reasonableness of the change, degree of impact on the counterparty, and to what extent the operator will conduct prior consultations. Further information and insight into this case will be available once the text of the ruling is made publicly available. Moreover, both parties have appealed the case to the Tokyo High Court. Close attention should be paid to the further developments to come.

[Author]

Nobuaki Ito, Partner
+81-3-6889-7632 nobuaki_ito@noandt.com
Nobuaki Ito provides a wide range of legal advice on antitrust and competition law matters, including merger control, cartel investigations, unilateral conduct, as well as other general corporate matters. He previously worked in the competition group of Ashurst (London office) as a visiting attorney from 2016 to 2017, and for the M&A Division of the Japan Fair Trade Commission as a Chief Investigator from 2017 to 2019 where he reviewed a number of high-profile M&A transactions (mainly in steel, pharmaceutical, chemical, IT, and energy sectors), and drafted the latest Merger Guidelines.

© 2022 Nagashima Ohno & Tsunematsu

PRIVATE EQUITY / VENTURE CAPITAL AND STARTUPS

Trends and market standards regarding startup investment in Japan

I. Introduction

According to a recent survey[2], the amount of total funds raised by startups incorporated in Japan reached a record high and exceeded JPY 800 billion in 2021 (the total funding amount was just shy of JPY 90 billion in 2013). Despite the weakening economy and stock market, the pace does not seem to have slowed down in the first half of 2022 during which startups have been reported, in the same survey, to have raised more than JPY 400 billion. Although higher growth rates can be observed in some other regions of the world, the startup industry in Japan has continued to grow steadily during this decade.

This growth has been aided by the Government's strong intention to support and further accelerate the growth of the startup industry in Japan. The Japanese Government's "Basic Policy on Economic and Fiscal Management and Reform", resolved and released by the Cabinet in June 2022 under the leadership of Prime Minister Kishida, who took the office in October 2021, mentions investment in startups as one of five focus areas with the aim of increasing the total amount of startup fundraising to ten times its current size within the next five years. Further details should become available in the five-year startup growth plan which the Government has promised to publish by the end of 2022.

In addition to the Japanese Government's efforts, the Japan Fair Trade Commission has been active in the area and has recently issued a number of reports and guidance in its efforts to create level playing field for startups in their transactions with large corporations or investors.

Among the growing number of startup investments in Japan, we are seeing an increasing number foreign investors. In the hope that this trend will continue and that the Government's policies will succeed in attracting more investments in Japanese startups from overseas, this article provides a brief overview of the Japanese market standards and legal requirements for startup investment in Japan.

II. Trends and Market Standards for Startup Investment Terms in Japan

(1) Overview

Unlike the NVCA Model Legal Documents in the United States or the Venture Capital Invement Model Agreements in Singapore, Japan does not have any publicly available, widely-used model startup financing documents. Startup financing documents are not standardized in Japan as in the United States and are written in Japanese in the vast majority of cases.

However, most startup investments have a similar equity structure, which is quite similar to the United States. A company issues common shares to the founders and possibly the first employees. Seed financing can be done through various ways (*i.e.,* common shares, preferred shares or convertible debt or equity), but, once the company reaches Series A, the financing is usually raised through preferred shares until the company's exit (convertible debt or equity is sometimes used as bridge). Employee stock options are also widely used, but stock options terms in Japan are generally less favorable to employees. For example, they are often structured as non-exercisable prior to an initial public offering and sometimes subject to vesting starting from the initial public offering. On average, the size of the stock option pool is smaller compared to that in the United States.

(2) Liquidation Preference and Other Terms

Generally speaking, the terms of preferred shares in Japan are more favorable to investors compared with preferred shares in the United States. Having said that, the terms of preferred shares have been changing to be more founder/company friendly in recent years. With respect to the liquidation preference, it is not rare

[2] Uzabase, Inc. "2022 1st Half Japan Startup Finance"

© 2022 Nagashima Ohno & Tsunematsu

to see more than a 1x (*e.g.,* 1.5x, 2x) liquidation preference and participation rights are still common. In other words, one should not necessarily interpret a 1.5x participation as a sign that the relevant company's previous series of financings were weak.

Whilst the terms of preferred shares usually include voting rights, mandatory and voluntary conversion and anti-dilution protection (mostly weighted-average), it is very rare to find a cash redemption right included.

In addition to a share purchase agreement, companies and shareholders usually enter into a shareholders agreement which stipulates director appointment rights, observer appointment rights, information rights, protective provisions, preemptive rights, co-sale rights, rights of first refusal and drag-along rights. In the shareholders agreement, the shareholders also agree on the distribution of proceeds from deemed liquidation events, which will be made in accordance with the terms of the liquidation preference.

Share purchase agreements usually include indemnification provisions as well as certain call options for purchasers that can be exercised upon, among other things, a breach of the representations or warranties or covenants by the company or founder(s). This may look overly burdensome for the company or founders and it has been actively discussed whether the industry should abandon such practice (as mentioned above, the Japan Fair Trade Commision plays an important role in such discussions), but is still very common in Japan, particularly for early stage startups. Startups try, and sometime succeed in, negotiating the removal of such call option in later stages.

(3) Foreign Exchange and Foreign Trade Act[3]

The Foreign Exchange and Foreign Trade Act (the "**FEFTA**") requires foreign investors to make a filing prior to making an investment in Japanese companies that operate in a designated business sector which includes, among others, software, data processing services and internet-use support sectors. With respect to acquisitions of shares in unlisted compnies, there is no applicable monetary or volume threshold such that filing is required for an acquisition of even a single share. In the ordinary course, it takes up to thirty days (typicaly shortened to somewhere between four business days and two weeks) after the filing has been submitted for the clearance in general. Clearance can take longer if there are any national security concerns.

III. Summary

Startup investment in Japan may appear confusing to international investors. However, putting any language issues aside, startup investment in Japan has largely developed based on the standard practices in the United States and should be familiar to investors accustomed to investing in the United States or other major jurisdictions.

[Author]

Akihiro Tokura, Partner
+81-3-6889-7273 akihiro_tokura@noandt.com
Akihiro Tokura is a partner at Nagashima Ohno & Tsunematsu. His practice focuses on mergers and acquisitions and venture capital investments. He was seconded to law firms in United States (Silicon Valley), Israel and Brazil and utilizes that experience to advise global and local clients in cross-border investments.

[3] For further details and recent updates on the FEFTA, please see Vol. 23 and 29 of NO&T Japan Legal Update.
https://www.noandt.com/en/publications/publication20330/
https://www.noandt.com/en/publications/publication20210930-2/

© 2022 Nagashima Ohno & Tsunematsu

CAPITAL MARKETS / ESG

Developments in sustainability and corporate governance disclosure in Japan

I. Introduction

On June 13, 2022, the Working Group on Corporate Disclosure of the Financial System Council, an expert council established under the Financial Services Agency of Japan (the "**Working Group**"), published its report (the "**Report**") regarding the proposed reformation of the corporate disclosure obligations of Japanese listed companies[4]. In the Report, the Working Group proposed (i) the strengthening of non-financial disclosures, including sustainability and corporate governance information, (ii) the revision of the quarterly disclosure system and (iii) the promotion of English language disclosures and other matters. In the months ahead, the Working Group will further discuss the forthcoming detailed rules and regulations regarding the corporate disclosure reformation based on the framework formulated in the Report. After the reformation, it is expected that an Annual Securities Report ("**ASR**") or other periodical report issued by a Japanese listed company under the Financial Instruments and Exchange Act of Japan (the "**FIEA**") will be required to contain detailed sustainability and corporate governance information.

II. Changes to Non-Financial Disclosures – Sustainability and Corporate Governance Disclosure

As seen in Europe, the United States and other countries, the Japanese Government has also been discussing the importance of non-financial disclosure by listed companies. Amid the situation where more and more domestic and foreign investors put greater emphasis on non-financial disclosures to make their investment decisions, the Working Group has discussed ways to enhance non-financial disclosures in Japan to cope with the increased demand.

(1) Sustainability

Under the FIEA, each Japanese listed company is obliged to file and disclose an ASR within three months after the fiscal year end. The ASR consists of, among others, (i) an outline of the company's business, results of operation and financial condition, including risk factors, MD&A, corporate governance and directors' remunerations, and (ii) the audited financial statements. While some companies disclose their corporate strategy or policy regarding sustainability matters in the MD&A or other sections, there is no specific section for sustainability in the current ASR format.

(i) Climate Change

In light of the above-mentioned views, in the Report the Working Group proposed creating a new section for disclosure of sustainability information. In this new section, "Governance" and "Risk Management" to cope with climate change will be disclosed by all companies. In addition, "Strategy" and "Metrics and Targets" regarding climate change will be disclosed depending on the materiality judgement by each company. Such new disclosure regime in the ASR regarding climate change is expected to essentially follow the regime that will be established by the International Sustainability Standards Board (ISSB) by the end of this year[5].

(ii) Human Capital and Diversity

The Working Group also discussed how to enhance disclosure regarding companies' strategy and policy on human capital and diversity. According to the Report, it is planned that "human resource development policies" and "policies on improving workplace environment" will be added to the disclosure items of the ASR. With respect to the disclosure of diversity within Japanese listed companies, "gender pay gap", "ratio of women in managerial positions," and "ratio of male workers taking childcare leave" will be added to the

[4] An English version of the summary of the Report is available at: https://www.fsa.go.jp/singi/singi_kinyu/tosin/20220613/03.pdf

[5] https://www.ifrs.org/projects/work-plan/general-sustainability-related-disclosures/

© 2022 Nagashima Ohno & Tsunematsu

disclosure items of the ASR.

(2) Corporate Governance

Under Japan's Corporate Governance Code, more and more Japanese listed companies have strengthened and improved monitoring functions by their Board of Directors by increasing the number and ratio of independent directors or establishing a Nomination Committee and/or Remuneration Committee. Japanese stock exchanges, including the Tokyo Stock Exchange, have encouraged listed companies to disclose such matters in a "Corporate Governance Report", a corporate governance disclosure document which is required under the rules of Japanese stock exchanges. In light of increased demand for corporate governance transparency, especially in relation to the monitoring function of the Board of Directors, the Working Group proposed that such information should be disclosed in the ASR as a mandatory disclosure item. Based on the Report, a new section will be created in the ASR for the disclosure of the activities of the Board of Directors, Nomination Committee, and Remuneration Committee.

III. Revision of the Quarterly Disclosure System

Under the current disclosure regime in Japan, each Japanese listed company is subject to quarterly earning release announcement (*Shihanki kessan-tanshin*) disclosure obligations as required under the listing rules of Japanese stock exchanges, as well as quarterly securities report (*Shihanki houkokusho*) disclosure obligations required under the FIEA. Such overlapping quarterly disclosure obligations has sometimes been criticized by certain companies and market participants.

In the Report, the Working Group announced that the quarterly securities report disclosure requirements for Q1 and Q3 under the FIEA will be abolished and integrated into the quarterly earning release announcement (*Shihanki kessan-tanshin*) under the listing rules of the stock exchanges. The Working Group will continue its discussions on issues related to the integration of such quarterly disclosures, such as the content of disclosure, enforcement against false statements and review by audit firms.

IV. Promotion of English Language Disclosures and Other Matters

In the Report, the Working Group also mentioned the importance of English language disclosure by Japanese companies to promote active investments by foreign investors. The Report clearly stated that the companies listed on the "Prime Market" of the Tokyo Stock Exchange are expected to proactively disclose an English version of the ASR, especially the risk factors, MD&A, corporate governance and status of shareholding sections. Based on the recommendation by the Working Group, it is expected that the FSA will publish a list of companies that disclose an English version of their ASR.

Furthermore, the Working Group pointed out the necessity of enhanced disclosure of material contracts entered into by a listed company that grants control of the listed company's corporate governance to certain shareholder, or that restricts the transfer of shares. Based on the Report, it is also expected that greater disclosure of financial covenants of loans and bonds will be included in the revision of the relevant ordinance.

© 2022 Nagashima Ohno & Tsunematsu

V. Conclusion

In the months ahead in 2022, the Working Group will further discuss the detailed rules and regulations regarding the corporate disclosure reformation based on the framework formulated in the Report. Although the specific schedule for the revision is not clear, according to the Japanese Government's Action Plan, the revision of the relevant ordinance is expected to be made by the end of this year, and the Government aims to start the enhanced non-financial information disclosure from the ASR for the fiscal year ending March 2023 at the earliest. With respect to the revision of the quarterly disclosure system, since such revision requires the amendment of the FIEA, it is expected that the Government will submit a related bill in the next ordinary session of the Diet to be held in 2023.

[Author]

Kyohei Mizukoshi, Partner
+81-3-6889-7673 kyohei_mizukoshi@noandt.com

Kyohei Mizukoshi is a partner at Nagashima Ohno & Tsunematsu. He provides legal services for general corporate matters, including capital market transactions, and advises on aspects of securities regulations. He also specializes in corporate governance and listing rules and regulations of Japanese stock exchanges. He regularly handles cross-border transactions for both Japanese and foreign clients.

This newsletter is given as general information for reference purposes only and therefore does not constitute our firm's legal advice. Any opinion stated in this newsletter is a personal view of the author(s) and not our firm's official view. For any specific matter or legal issue, please do not rely on this newsletter but make sure to consult a legal adviser. We would be delighted to answer your questions, if any.

NAGASHIMA OHNO & TSUNEMATSU www.noandt.com

JP Tower, 2-7-2 Marunouchi, Chiyoda-ku, Tokyo 100-7036, Japan
Tel: +81-3-6889-7000 (general) Fax: +81-3-6889-8000 (general) Email: info@noandt.com

Nagashima Ohno & Tsunematsu is the first integrated full-service law firm in Japan and one of the foremost providers of international and commercial legal services based in Tokyo. The firm's overseas network includes offices in New York, Singapore, Bangkok, Ho Chi Minh City, Hanoi and Shanghai, and collaborative relationships with prominent local law firms throughout Asia and other regions. The over 500 lawyers of the firm, including about 40 experienced attorneys from various jurisdictions outside Japan, work together in customized teams to provide clients with the expertise and experience specifically required for each client matter.

If you would like to receive future editions of the NO&T Japan Legal Update by email directly to your Inbox, please fill out our newsletter subscription form at the following link: https://www.noandt.com/en/newsletters/nl_japan_legal_update/
Should you have any questions about this newsletter, please contact us at <japan-legal-update@noandt.com>.
Please note that other information related to our firm may be also sent to the email address provided by you when subscribing to the NO&T Japan Legal Update.

© 2022 Nagashima Ohno & Tsunematsu