

I. PROCEDURAL HISTORY

1.1 On 13 June 1996, the United States requested consultations¹ with Japan pursuant to Article 4.4 of the Dispute Settlement Understanding (DSU) and Article XXIII:1 of the General Agreement on Tariffs and Trade 1994 (GATT) regarding certain laws, regulations and requirements of Japan affecting the distribution, offering for sale and internal sale of imported consumer photographic film and paper.² The United States considered that the Japanese measures specified in its consultation request violated the obligations of Japan under GATT, including Article III and Article X, and that those measures nullified or impaired benefits accruing to the United States directly or indirectly under GATT, within the meaning of Article XXIII:1(a) and (b). The United States further stated that it reserved the right to raise additional factual claims and legal matters during the course of the consultations. The consultations were held on 11 July 1996, but failed to resolve the dispute.

1.2 On 20 September 1996, the United States requested the establishment of a Panel pursuant to Articles 4 and 6 of the DSU.³ In its request, the United States alleged that Japan has implemented and maintains certain laws, regulations, requirements and measures (hereinafter collectively "measures" or "'countermeasures'")⁴ affecting the distribution, offering for sale, and internal sale of imported consumer photographic film and paper. The US considered that such measures nullify or impair benefits accruing to it, within the meaning of Article XXIII:1(a), as a result of the failure of Japan to carry out its obligations under Articles III and X of GATT. More specifically, the United States claimed that the Japanese Government measures:

- a. were implemented and maintained so as to afford protection to domestic production of consumer photographic film and paper within the meaning of Article III:1 of GATT;
- b. conflict with Article III:4 of GATT by affecting the conditions of competition for the distribution, offering for sale, and internal sale of consumer photographic film and paper in a manner that accords less favourable treatment to imported film and paper than to comparable products of national origin; and
- c. conflict with Articles X:1 and X:3 of GATT because the measures lack transparency in that they were not promptly published and were not administered in a uniform, impartial and reasonable manner.

In addition, the United States claimed that the application of these measures by Japan nullifies or impairs, within the meaning of Article XXIII:1(b) of GATT, the tariff concessions that Japan made on black and white and colour consumer photographic film and paper in the Kennedy Round, Tokyo Round, and Uruguay Round multilateral tariff negotiations. The US claims are discussed in more detail in Part III below.

¹The request was circulated as WT/DS44/1 on 21 June 1996.

²The term "consumer photographic film" as used by the United States includes both colour and black and white film designed and used for capturing personal images by consumers through still photography using silver halide technology. It includes both negative and reversal (slide) film, and includes film incorporated in so-called "single-use cameras" which are returned along with the film to the photoprocessing facility. It excludes various specialized films used by professional photographers for resale ("professional" film) and various other specialty films (x-ray film, microfilm). The term "consumer photographic paper" as used by the United States refers to photosensitive paper used to make still colour and black and white photographic prints from consumer photographic film for the images and applications typically demanded by consumers.

³The request was circulated as WT/DS44/2 on 23 September 1996.

⁴The parties disagree on the translation on the Japanese word *taisaku*. The United States uses "countermeasure", whereas in Japan's view, "measure" or "policy in response to" are more adequate. See Annex on Translation Problems, translation issue 1.

1.3 At its meeting on 16 October 1996,⁵ the Dispute Settlement Body (DSB) established a Panel in accordance with Article 6 of the DSU. However, since Japan expressed its concerns about the procedural problems of the US panel request, the DSB agreed that the terms of reference were to be drawn up by the parties to the dispute within 20 days in accordance with Article 7.1 of the DSU. The parties to the dispute failed to agree on the terms of reference and, as a result, the standard terms of reference as set out in Article 7.1 of the DSU were applied:

"To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS44/2, the matter referred to the DSB by the United States in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements".⁶

1.4 The European Communities and Mexico reserved their rights as third parties to the dispute.

1.5 On 12 December 1996 the United States, pursuant to Article 8.7 of the DSU⁷, requested the Director-General to determine the composition of the Panel.

1.6 On 17 December 1996, the Director-General composed the Panel as follows:

Chairman:	Mr. William Rossier
Members:	Mr. Adrian Macey
	Mr. Victor Luiz do Prado

1.7 The Panel held two substantive meetings with the parties to the dispute. The first was held on 17 and 18 April 1997, and the second on 2 and 3 June 1997. The Panel had one meeting with the third parties to the dispute, on 18 April 1997.

1.8 In view of the fact that the dispute involved the consideration of a large volume of documents, which were predominantly in the Japanese language, it was essential that these documents be translated into the working language of the Panel, which was English. It was essential that such translations be correct, and that in the event of any disagreement between the parties as to the correct translation, a mechanism be established to resolve such translation problems.

1.9 In this regard, the Panel, in consultations with the parties, drew up Procedures for the Resolution of Possible Translation Issues. These provided as follows -

1. The party first relying on a Japanese-language document in a written submission or oral presentation shall provide copies of the full Japanese-language document and the relevant portions in English at the time that the party first makes reference to the document in the Panel proceedings.

2. If one party believes that additional portions of a previously submitted document are relevant, it shall then supply the additional translation at the time that that party first makes reference to the document in the Panel proceedings.

⁵WT/DSB/M/24.

⁶WT/DS44/3, dated 7 December 1996.

⁷Article 8.7 of the DSU: "If there is no agreement on the panelists within 20 days after the date of the establishment of a panel, at the request of either party, the Director-General, in consultation with the Chairman of the DSB and the Chairman of the relevant Council or Committee, shall determine the composition of the panel by appointing the panelists whom the Director-General considers most appropriate in accordance with any relevant special or additional rules or procedures of the covered agreement or covered agreements which are at issue in the dispute, after consulting with the parties to the dispute. The Chairman of the DSB shall inform the Members of the composition of the panel thus formed no later than 10 days after the date the Chairman receives such a request".

3. If one party disagrees with the other party's translation of a Japanese-language document or portion thereof, it shall prepare an alternative version of the contested portion of the translation. This shall be submitted to the Panel and to the other party with supporting written argumentation as needed. The other party may also submit its argumentation at this stage.

4. To the extent relevant for the resolution of the legal issues involved in this case, the Panel shall attempt to resolve any translation problem submitted to it, having recourse as necessary to independent experts appointed by the Panel, or to such other means as the Panel deems appropriate to the circumstances.

1.10 The Panel appointed the following translation experts:

Professor Zentaro Kitagawa, Kyoto Comparative Law Center, Kyoto, Japan; and

Professor Michael Young, Center for Japanese Legal Studies, Columbia University School of Law, New York, USA.

1.11 The translation problems raised by the parties which were submitted to the experts, and the responses by both experts are attached to this report in an "Annex on Translation Problems".

1.12 The Panel issued the descriptive part to the parties on 22 September 1997. The interim report was issued on 5 December 1997. Pursuant to Article 15.2 of the DSU, both parties submitted written requests for the Panel to review precise aspects of the interim report on 19 December 1997, but did not ask for a further meeting to discuss the issues identified in their requests. The Panel issued the final report to the parties on 30 January 1998.

II. SUMMARY OF FACTUAL ASPECTS

A. THE MARKET FOR PHOTOGRAPHIC FILM AND PAPER IN JAPAN

2.1 This dispute concerns the distribution of imported *consumer* photographic film and paper in Japan. Throughout this report, the terms "photographic film and paper" and "photographic materials" shall be understood to mean consumer photographic film and paper or consumer photographic materials.

2.2 The history of the Japanese tariff bindings and applied rates for photographic film and paper in Japan are as follows:

ROUND	<u>FILM</u>		<u>PAPER</u>	
	B&W	Colour	B&W	Colour
Pre-Kennedy (1964)	30% *	40% *	25% *	40% *
Kennedy Round (1967)	15.0%	40% *	12.5%	40% *
Tokyo Round (1979)	7.2%	4.0%	6.6%	4.0%
Uruguay Round (1994)	Free	Free	Free	Free

(* = Applied, not bound)

Until 1970-72, black and white film and paper were the predominant products used in Japan. Thereafter, the dominant products were colour film and paper. Today, colour film and paper account for 97 percent of Japan's total market for consumer photographic materials, with black and white film and paper accounting for only 3 percent.

2.3 Japan's photographic materials market is supplied by four manufacturers, two domestic and two foreign.⁸ The two domestic manufacturers are Fuji Photo Film, Ltd. (Fuji), and Konica Corporation (Konica). The two foreign manufacturers, Eastman Kodak Company of the United States (Kodak) and Agfa-Gevaert Aktiengesellschaft of Germany (Agfa).

2.4 **Japan** notes that since 1965 the share of imports in the Japanese market for colour film has ranged from 9 percent to a peak of 20.0 percent in 1981. According to the **United States** and **Japan**, the import share of the Japanese market for photographic film was around 15 percent by 1995 and that of this, Kodak's share is around 10 percent and Agfa's around 5 percent of the market. **Japan** further submits that for black and white film the share of imports has ranged from about 2 percent in 1965 peaking at around 41.4 percent in 1985 and settling at around 25 percent by 1995. According to Japan, Kodak's share of the black and white market has increased from 3.6 percent in 1967 to a peak of 17.6 percent in 1983.

2.5 The **United States** submits that foreign film manufacturers distribute all of their film through wholly-owned local sales subsidiaries. Two-thirds of Kodak film is, in turn, sold to retailers, 9 per cent is sold to so-called secondary photospecialty wholesalers, with the remaining sold through Kodak-affiliated photofinishing laboratories. Agfa's local subsidiary sells 90 per cent of its film to retailers and the rest to secondary wholesalers. Fuji sells all of its film to primary wholesalers, who then resell through regional secondary wholesalers and 8 per cent through laboratories, while the remainder is sold direct to retail. Konica sells through sales subsidiaries that were once independent photospecialty wholesalers.

⁸Polaroid, which specializes in instant-print film, also sells photographic materials in Japan. However, the United States is not claiming nullification and impairment or violation with regard to instant-print film. Two domestic manufacturers, Oriental Photo Industrial Co., Ltd. and Mitsubishi Paper Mills, Ltd., produce paper only. All four domestic photographic manufacturers distribute paper to photo finishing laboratories.

2.6 According to the **United States** and **Japan**, photographic film is sold in Japan by 280,000 retailers. These retailers can be divided into three groups:

(a) Traditional photospecialty stores, whose primary line of business is the sale of film, cameras and accessories. There are some 30,000 such stores, selling roughly half of the film sold in the Japanese market.

(b) General merchandise stores (including supermarkets and discount, department, drug and convenience stores). There are some 70,000 such stores, selling roughly one-third of the film sold.

(c) Other retail outlets (including kiosks, tourist resorts, parks and other small outlets). There are some 180,000 such outlets, selling the remainder of the film not sold by traditional photospecialty and general merchandise stores.

B. JAPANESE ENTITIES AND MEASURES RELATED TO THE US CLAIMS

2.7 As summarized in Sections III and IV, the claims raised by the United States concern two principal government agencies, several councils and business associations, and numerous specific measures. The "countermeasures" are divided by the United States into three broad categories: (1) distribution "countermeasures", which allegedly encouraged and facilitated the creation of market structures for film and paper in which imports are excluded from traditional distribution channels (collectively referred to by the United States as "distribution countermeasures"); (2) the Large Stores Law, which allegedly restricts the growth of an alternative distribution channel for film; and (3) restrictions on premiums and misleading representations under the Premiums Law, which allegedly disadvantage imports by restricting sales promotions (collectively referred to by the United States as "promotions countermeasures"). The United States refers to the three sets of measures collectively as "liberalization countermeasures."⁹

2.8 This section contains descriptions of the two principal Japanese government agencies and other entities (i.e., several councils and business associations) whose activities have been challenged by the United States. The provisions of specific measures challenged by the United States are described in relevant parts under the relevant entity, except for the 1967 Cabinet Decision, which is set out separately at the beginning. The provisions of these measures are set out here so as to provide a single reference point containing the background and text of these measures for the arguments of the parties and the findings of the Panel. The inclusion of a measure or selected text of a measure in this section does not address whether it is a "measure" as that term is used in a technical sense in any particular GATT provision.

1. 1967 CABINET DECISION

2.9 The United States focuses attention on the Cabinet Decision Concerning Liberalization of Inward Direct Investment of 6 June 1967 ("1967 Cabinet Decision").¹⁰ This was a decision of the Cabinet of the Government of Japan regarding liberalization of direct investment and the "(counter)measures"

⁹According to the United States, the "distribution countermeasures", Large Stores Law and related measures, and "promotion countermeasures" in combination nullify or impair benefits within the meaning of Article XXIII:1(b). The "distribution countermeasures", as a set, also violate Article III:4 and nullify or impair benefits within the meaning of Article XXIII:1(b). The Large Stores Law and related measures also nullify or impair benefits within the meaning of Article XXIII:1(b), in the context of the restrictive distribution structure in Japan. And, the promotions countermeasures, as a set, nullify or impair benefits within the meaning of Article XXIII:1(b), in the context of the restrictive distribution structure in Japan. The specific failures to publish laws, regulations, or administrative rulings of general application discussed below each constitute a violation of Article X:1.

¹⁰1967 Cabinet Decision, US Ex. 67-6.

that should be taken in proceeding with liberalization. The Government of Japan had requested the Foreign Investment Council ("FIC") to conduct an enquiry regarding inward direct investment. It was on the basis of the report of this Council that the Government of Japan made its Decision. In this decision the Japanese Government expressed its support for the Report of the Foreign Investment Council Expert Committee of 2 June 1967 ("1967 FIC Report").¹¹ The FIC was established pursuant to the Law Concerning Foreign Investment, which provided it would be established as an organization attached to the Ministry of Finance with the Minister of Finance as its chairman.¹² The 1967 FIC Report was, in turn, based on the Report of the FIC Expert Committee of 17 May 1967 ("1967 FIC Expert Committee Report").¹³ Regarding the regulation of unfair trade practices, the 1967 FIC Expert Committee Report also stated what follows:

"(1) When foreign capital is brought into Japan, it is possible for a parent company to use vast amounts of capital to engage in dumping, offer premiums, and conduct large-scale publicity and advertising, etc. In the future, as liberalization of direct investment in the domestic market progresses, such risk may conceivably be reinforced. Therefore, in such a situation, it is necessary to fully study whether these actions qualify as unfair trade practices as defined in Article 2 of the Antimonopoly Law and can be regulated pursuant to provisions under Article 19 of the said Antimonopoly Law or the Law Against Unjustifiable Premiums and Misleading Representations.

(2) For the application of the Antimonopoly Law, while one may not specifically select foreign capital affiliated firms for differential treatment, foreign capital affiliated firms nevertheless have the strong capital and technological background of the parent company and are usually in an economically strong position. Consequently, it is believed that they will often become the object of regulation of the Antimonopoly Law. On this point, we must be able to apply standards to deal with any disorderly activities by foreign capital because existing standards of regulation of unfair trade practices are not necessarily clear and we may, for example, clarify them by making use of a special designation or some other method".¹⁴

(3) For the provision of large-scale premiums, it is believed that establishing fair competition codes pursuant to the [Premiums Law] with assistance from the industry that might be affected, would be an effective ["countermeasure"]".¹⁵

The 1967 Cabinet Decision provided the following basic direction for the "(counter)measures" to be taken in carrying out capital liberalization:

"One. Basic Policy Concerning the Liberalization Inward Direct Investment

1. Basic Attitude Toward the Liberalization of Inward Direct Investment

Our country has been endeavouring to deepen its ties with the international economic community through such means as the liberalization of foreign trade, foreign exchange and participation in the Kennedy Round tariff cut negotiations. Now we are prepared to move forward also with regard to the liberalization of capital movements.

¹¹US Ex. 67-5A.

¹²Article 19 of the Foreign Investment Law.

¹³US Ex. 67-5B.

¹⁴Ibid., p. 3.

¹⁵Ibid.

Under these internal and external circumstances, it is time to gather the energy and wisdom of the [Japanese] people in order to further develop our economy and to improve the standard of living. For the liberalization of capital movements, and in particular, the liberalization of inward direct investment, which is an issue with this Council, it has been determined that this country should be taken to deal with them as independent tasks, in order to deepen cooperation with the international economic community and plan the long-term development of our own economy ...

As for our national economy as liberalization progresses, although foreign capital may advance in to many of our industries, it is hoped that our firms will be able to compete fairly and effectively with them fairly and cooperate with them on equal terms, thereby promoting national economic interests. The largest future goal of the people, business circles and government must be the swift attainment of such a stage by our national economy ...

In order to facilitate such activities on the part of the private sector, and guide and complement these efforts, the government, too, must make unprecedented efforts to revitalize science and technology and research and development, while paying close attention to the improvement of industrial system and the financial system so as to create an environment in which the economy can cope with liberalization. At the same time, the government should take the initiative by setting an example of good administration befitting the age of liberalization by making its own finance and administration efficient and modernized and lowering the cost of administration. It is hoped that such efforts will build the basis on which our enterprises can compete against foreign capital on equal terms. The measures for liberalization should be reviewed after an appropriate interval of one to two years to expand the scope of liberalization, taking into consideration the results of efforts made by the private sector and the effect of government measures.

...

If, therefore, our enterprises are to compete against foreign capital on equal terms, the following would be necessary: companies must improve their own quality and pursue the organization of the industrial system, intensively strengthen the capacity for technological development, organize the financial system in parallel with the organization of the industrial system, and lower of long-term interest rates.

On the other hand, it would be necessary to restrain foreign enterprises coming into Japan after liberalization from disturbing order in domestic industries, by resorting to the strength of their superior power, and from advancing into the non-liberalized sectors by evading control.

The establishment of these "(counter)measures" for strengthening the capacity of our enterprises for international competition and for preventing foreign enterprises from disturbing order in our industries and market would be a basic necessity if the liberalization is to be promoted and if our people are to enjoy its economic benefits.

...

The basic direction of the "(counter)measures" that the government should adopt are the following three points:

- 1) Prevent disorder that may arise from the advancement of foreign capital;

- 2) Create the foundation to enable our enterprises to compete with foreign enterprises on equal terms;
- 3) Actively strengthen the quality of [domestic] enterprises and reorganize the industrial system so that they can fully compete with foreign capital.¹⁶

...

Modernization lags behind most in the distribution sector. Here, the power of resistance against the inroad of foreign capital is weak, and the impact of foreign capital advancing into this sector will also pose significant impact on the production sector. It is necessary, therefore, to implement countermeasures in support of the efforts of industry with the objectives of modernizing the distribution structure, fundamentally strengthening the enterprises in this sector, and establishing a mass sales system."¹⁷

2.10 **Japan** submits that the 1967 Cabinet Decision was formally repealed 26 December 1980.¹⁸ The **United States** contends that the repeal affects only the portion of the Cabinet Decision relating to controls on international investment in Japan. The United States alleges that the 1980 decision did not revoke the distribution policies and liberalization "countermeasures" directed by the 1967 Cabinet Decision.

2. *MITI AND RELATED ITEMS*

2.11 The US submissions focus in particular on the activities of the Japanese Ministry of International Trade and Industry (MITI). Among other things and of particular concern in this proceeding, according to the United States, MITI established various groups in the 1960s and 1970s to examine issues related to distribution of goods, both generally and in respect of photographic materials. In addition, MITI is responsible in part for the implementation of the Large Scale Retail Store Law, one of the principal measures challenged by the United States.

(a) **Industrial Structure Council Distribution Committee: Sixth and Seventh Interim Reports**

2.12 The United States notes that in 1964, MITI established the Industrial Structure Council, authorizing it to "investigate and examine important issues concerning industrial structure" in response to an inquiry by the MITI Minister.¹⁹ The Industrial Structure Council is an advisory council, composed of academics and industry representatives. MITI plays an important role in staffing²⁰ the Council and the general affairs of the Council are managed by MITI, its Industrial Policy Bureau and Industrial

¹⁶MITI History Vol. 17, pp. 379-388, (provisional translation) US Ex. 67-6, pp. 3-4.

¹⁷1967 Cabinet Decision, p. 6, US Ex. 67-6. According to the **United States**, on the same day the Cabinet announced its decision, the Chief Cabinet Secretary issued a formal statement directing foreign firms to inter alia: "collaborate with our industry's efforts to voluntarily maintain order; cooperate with the improvement of international balance of payments, such as export promotion; hire Japanese nationals as executives ... [and] cooperate with the economic policies of the government." Chief Cabinet Secretariat Talk, Regarding Implementation of Liberalization Measures for Inward Direct Investment, 6 June 1967, reprinted in Yoshida Fujio, Capital Liberalization and Foreign Investment Law, 30 October 1967, p. 160, US Ex. 67-16.

¹⁸Cabinet Decision of 26 December 1980 Concerning the Application Policy of Inward Investments, Japan Ex. B-55.

¹⁹Article 102 of the Cabinet Order No. 390. The Industrial Structure Council Order provides that the ISC be "composed of no more than 130 members" to be "appointed by the Minister of International Trade and Industry." Industrial Structure Council Order, Cabinet Order No. 79, 31 March 1964, Japan Ex. B-3.

²⁰**Japan** disagrees with the US allegation that the Distribution Committee was staffed by MITI officials and contends that the Industrial Structure Council including the Distribution Committee consists of persons with learning and experience appointed by MITI. Investigations, deliberations, and decision-making are all carried out by the members. According to Japan, although MITI officials sometimes attended meetings as observers, they take no part in the decision-making process.

Structure Division.²¹ The Industrial Structure Division has responsibility for "matters pertaining to the Industrial Structure Council".²²

2.13 The United States notes that the Council established the Distribution Committee to study and report on matters relating to the Japanese distribution system. The Distribution Committee issued 19 interim reports between 1964 and 1995. Both parties refer to a number of these interim reports in their submissions and the United States lists two of them, the Sixth Interim Report on "Distribution Modernization Outlook and Issues (5 August 1968)²³ and the Seventh Interim Report on "Systemization of Distribution Activities" (22 July 1969)²⁴, as among the specific measures that it is challenging in this dispute. As set out in the description of the parties' arguments, the parties cite different parts of the reports to support their contentions as to the general thrust of the reports.

(i) The 1968 Sixth Interim Report

2.14 The Sixth Interim Report dealt with a broad spectrum of issues with a bearing on distribution. These issues were categorized into four parts:

- (i) the strengthening and modernizing of persons in charge of distribution functions;
- (ii) the adjustment of market conditions;
- (iii) the rationalization of physical distribution;
- (iv) the adjustment of the environment which is the common basis for the realization of these issues.

The Report listed the goals of distribution policy for the next five years as:

- (i) organization and cooperative business formation;
 - (1) the formation of voluntary chains;
 - (2) the formation of combinations among stores in the retail industry group department stores, group supermarkets, universal markets, etc.;
 - (3) the redevelopment or construction in shopping districts;
 - (4) the integration of functions based on wholesale industry collectivization (general wholesale centres, wholesale trade complexes);
- (ii) the modernization of management methods and facilities;
- (iii) securing the labour force and education of personnel;
- (iv) the rationalization of trade practices and trade system;
- (v) reform of physical distribution technology;
- (vi) the rationalization of conditions of location;
- (vii) the formation of a distribution information network and improvement of statistics;
- (viii) facilitating financial aspect of distribution.

According to the United States, the Report also addressed the negative impact liberalization could have on distribution in Japan, notwithstanding that liberalization could rationalize and modernize the Japanese distribution system:

²¹Article 7 of the Industrial Structure Council Order, US Ex. 64-1 and Japan Ex. B-3.

²²The United States provides in US Ex. 52-2 the following translation:

The Industrial Structure Division is in charge of the following administrative matters:

1. development of, as well as comprehensive coordination in implementing, the policies and plans relating to the industrial structure relating to business under the supervision of the MITI;
2. general management of administrative matters pertaining to new industries under the supervision of the MITI; and
3. matters pertaining to the Industrial Structure Council.

²³US Ex. 68-8, and Japan Ex. B-7.

²⁴US Ex. 69-4.

1. There is a risk that growth sectors will fall under the monopolistic control of foreign capital, resulting from the difference in capital resources and the like.
2. There is a risk that the process of sales expansion by foreign capital affiliated distribution enterprises will aggravate excessive competition and hinder the smooth implementation of distribution modernization plans, and the [established] order of trade will be disrupted.
3. There is a risk that the manufacturing sector will be dominated by controlling the sales routes, bringing about the international subcontracting of Japanese industry.²⁵

(ii) The 1969 Seventh Interim Report

2.15 The United States also submits that the Seventh Interim Report was issued as a "first step in meeting the challenges currently facing Japan's distribution sector". Although the Report notes that the aim of systemization²⁶ in the distribution system was to improve functionality and productivity, it specifically identified the threat of foreign capital as a reason to reform the distribution sector:

"Today, amidst calls for the active promotion of capital liberalization in the distribution sector, we think that efforts to systemize distribution have a vital importance in strategic significance. ... [T]he systems gap [between Japan and America] is expected to have a decisive effect on distribution activities in particular, the concerted efforts of the government and the private sector must be directed at systemization from the point of view of a capital liberalization countermeasure.

...

[I]t is true that one effect of systemizing Japan's distribution system is the simplification of entry [into Japan's market] by foreign capital, [enterprises] which are more adept at systems methodology. [But] to make inroads, we should instead emphasize preventing the immense impact that would be felt if foreign capital took the lead in systemizing Japan's distribution activities, and quickly develop a system sufficiently capable of countering the rational systems introduced by foreign capital."²⁷

In the US view, the Report acknowledged that systemization must be approached by looking at the distribution system as a single whole and not as a cluster of separate and individual distribution functions. It was acknowledged that with respect to goods, the most important factor is distribution, and that systemization could only progress around the centralized processing of physical distribution control at distribution centres and stock points. The Committee identified three approaches to systemization:

- (i) the commodity approach;
- (ii) the institutional approach;
- (iii) the functional approach.

The Committee proposed the following policies for the government to adopt:

²⁵Sixth Interim Report, p. 8, US Ex. 68-8.

²⁶It is Japan's view that MITI distinguished rationalization and systematic policies. The United States does not follow this distinction and uses the single term "systemization" to cover both concepts.

²⁷Industrial Structure Council Distribution Committee, Systemization of Distribution Activities (Seventh Interim Report), 22 July 1969, p. 4, US Ex. 69-4.

- (i) establishing a Distribution Systemization Council;²⁸
- (ii) presenting guide posts and promoting standardization;
- (iii) establishing a system for providing distribution-related information;
- (iv) providing incentives in the areas of financing, taxation, etc.

(b) 1969 Survey on Transaction Terms

2.16 In 1968, the Institute for Distribution Research, a private, but MITI-affiliated organization, was commissioned by MITI to conduct a survey of transaction terms in several industries. Its survey on transactions terms in the film industry (1969 Survey)²⁹ was submitted by the Institute to MITI in 1969, and (re-)published by MITI in 1971.³⁰ The purpose of this Survey was "to research current trade practices, isolate problems, and prepare basic materials to develop and spread rational trade practices."³¹ The Survey identified foreign companies and changes in distribution as problems:

"As we have already seen, there is a view and an impression that the industry of general use photographic film, based on an oligopoly of two domestic manufacturers, is superficially in a stable and normal state in which contract formation and documentation of transactions are progressing. Consider, however, one postulate:

- (1) If the oligopoly of the two domestic manufacturers is broken up by a foreign company; and
- (2) If a new [distribution] route emerges to compete against the route of photographic material dealers, which is the core existing route in the distribution market.

There may be very few observers who have a sense of crisis regarding (1) and (2) as realistic issues; however, they should now be considered as the most concrete and realistic problems.³²

Based on these perceived problems, the Survey made the following policy recommendation:

Given this situation, it is necessary to formulate measures before hand in order to minimize the anticipated disorder in the distribution market. This is why it is significant to rationalize and standardize transaction terms and to create an [established] order of distribution.³³

²⁸See section II.B.1.(d) (discussing the establishment of the Distribution Systemization Promotion Council, which produced the 1971 Basic Plan for the Systemization of Industry).

²⁹Institute of Distribution Research, Fact-Finding Survey Report Pertaining to Transaction Terms: Actual Conditions of Transaction Practices in the Wholesale Industry, March 1969, US Ex. 15. The survey became the basis for MITI's July 1970 "Guidelines for the Standardization of Transaction Terms for the Photofilm Industry." See p. 3, US Ex. 70-4. According to the United States, in 1971, MITI republished an edited version of the survey under its own name. MITI Business Bureau, Actual Conditions of Transaction Terms in the Wholesale Industry, 21 August 1971, US Ex. 20.

³⁰The parties disagree on the publication date of the 1969 Survey. According to the **United States**, the 1969 Survey was published in 1969 and re-published by MITI in 1971. **Japan** contends that in 1969, the Institute for Distribution Research submitted the survey to MITI and that it was published by MITI only in 1971.

³¹US Ex. 20, p. 7.

³²US Ex. 15, p. 62.

³³Ibid., p. 63.

(c) 1970 Guidelines for Rationalizing Terms of Trade for Photographic Film

2.17 In 1970, MITI's Transaction Terms Standardization Committee, published "Guidelines for Rationalizing Terms of Trade for Photographic Film" (1970 Guidelines)³⁴. The Committee was set up by MITI to study the question of standardization of transaction terms in industry generally, and in light of capital liberalization, more specifically.³⁵

2.18 According to the United States, the introduction of the 1970 Guidelines noted that, "[I]n order to prevent disruption of the established order of trade by foreign businesses with powerful capital strength, the standards for rational transaction terms must be clarified."³⁶

2.19 The guidelines were as follows:

"I. Transaction terms concerning sales contracts

(1) Stocking method

Current situation. The most commonly used stocking method for both the wholesalers (i.e., resalers) and retailers is purchasing.

(2) Discounts

Current situation. When we look at the current situation of the cash discount system (the system of discounting transaction price according to the length of the account payment period) mainly among the wholesalers, we see that a large number of businesses receive discounts for purchasing, and over half of the businesses use this system for selling as well. Furthermore, for the most of these, the criteria for discounting appear to be made clear in advance.

Concerning the volume discount system (the system of discounting the transaction price according to the volume of a single order), the majority of wholesalers enjoy this system for purchasing, but only a few use it for sellers. The volume discount has generally come to be used less as the size of the transaction grows, because the burden on the seller is greater.

Problems and Direction of Corrective Measures. Both the cash discount and volume discount systems are relatively systematized, but the discount amount is often paid at a fixed date such as at the end of a [certain] term after the completion of the transaction, this practice makes it difficult to differentiate from a rebate. It is best if the corresponding amount is discounted and settled at the time of account settlement since then the discount criteria is made clear in advance. A negative trend is seen for volume discounts, but it is desirable to move in the direction of using them in the photo film industry from the perspective of reducing distribution costs.

(3) Rebates

Current situation. For rebates (returning to the buyer a portion of the amount paid by the buyer) from the wholesales suppliers, most businesses receive rebates in much the same way as discounts. There are three ways to receive rebates: directly

³⁴US Ex. 70-4, and Japan B-24.

³⁵Ibid.

³⁶Ibid., p. 2. This policy objective was reiterated in the 1971 Basic Plan. See section II.B.1.(d).

from the manufacturer, from the manufacturer through the tokuyakuten, and as the tokuyakuten's own rebate. The main types of rebates are a fixed-rate rebate, settlement rebate, and the goal achievement rebate; cumulative rebates are rare.

Approximately 30 percent of the wholesalers provide rebates to their purchasers, which is substantially lower than the percentage [of wholesalers] who receive rebates.

Problems and the Direction of Corrective Measures. In general, the rebate [system] depends on the seller's discretion. It is widely used, therefore, as a means of controlling the distribution process. When this is excessively done, however, this practice could be an unfair trade practice under the Antimonopoly Law. Even when it does not go that far, it can lead to substantial control of a distribution channel, and make it difficult for the recipient of the rebate to make clear management plans. Subsequently, this practice may cause the problem of preventing the merits [of the rebate system] from being passed on to the final price. Moreover, the rebate system has recently become so complicated that negative aspects such as an increased administrative burden have arisen. It is the principle of the discount system to pass on the advantages gained from large-volume transactions and the like to consumers. Although we recognize that rebates have a supplemental role in other price policies, this should be kept to a minimum.

II. Transaction terms for the delivery of goods

(1) Frequency of delivery of goods

Current situation. The frequency of goods delivery to purchasers by wholesalers ranges from daily and once every two weeks or more to no delivery. A noteworthy point is that as many as 30 percent of all businesses make deliveries every day to all of their purchasers. This is thought to be due to the importance of delivery as an element of the wholesale function and also due to the fact that orders are taken and market information is gathered at the delivery. Over half of the wholesalers expressed negative opinions about setting regular delivery dates and charging fees for deliveries made on the other days.

Problems and Direction of Corrective Measures. As mentioned above, delivery frequency is highly regarded as one important function of wholesaling, and its frequency is not really regarded as a problem. It is believed, however, that the changes in the economic environment surrounding the distribution sector such as labour shortages and the worsening traffic situation will not allow this custom to continue indefinitely. Therefore, it is recommended that, in principle, wholesalers make deliveries twice a week for the time being, and impose charges for special services.

(2) Arrangements for minimum orders per delivery

Current Situation. Although wholesalers will make deliveries even every day if there's sufficient quantity, they are willing to set minimum delivery requirements. At present, however, almost no such arrangements are being made. Approximately half [of the wholesalers] want to implement minimum delivery requirement arrangements and believe it to be feasible.

Problems and the Direction of Corrective Measures. Due to the nature of the product, demand is less diversified compared to other products. It is necessary to set a minimum delivery requirement to reduce distribution costs.

(3) Returned goods

Current situation. Generally, there are not many returns. In particular, returned goods from wholesalers (tokuyakuten and resalers) are rare. The number of returned goods from retailers to wholesalers is also low.

III. Transaction terms for account settlement

Current situation. The collection method of wholesalers is generally "collection on a specific date after the due date", but "collection on delivery" is also relatively frequently used.

Collection on a specific date includes both collection of the full amount and collection of the partial amount; it is determined by the size of the retailer and its cash flow. Cash collection is more frequent in most cases compared with the collection of notes. The most common sight of a note is between 61 to 70 days.

A common payment method of the wholesalers is "payment of the full amount on a specific date after the due date". Although cash payment is more commonly used than notes, the percentage of note payments made by the wholesalers is higher than that of the collections made from the retailers. The most common sight [credit] of a note is approximately 60 days.

Problems and Corrective Measures. In both payment and collection mainly by wholesalers, cash settlement is predominant and the sight [credit] notes are shorter compared with those of other products. The practice of partial payment is particularly prevalent among retailers; leaving the balance on credit destabilized the term-end book closing. Consequently, it makes the entire transaction uncertain, thus, inhibiting the - promotion of reasonable terms of trade such as a discount system. Therefore, the account should be settled in full with cash and a promissory note. Also, while still only few in number, there are promissory notes with unusually long sight. For such promissory notes, appropriate interest should be charged on the same principle as the cash discount system.

IV. Dispatched employees

Current Situation. Dispatched employees are rarely seen at general photography materials retailers. There are dispatched employees in the DPE departments of large retailers; however, few are systematized practices and the dispatch is made only in special cases".

(d) **1971 Basic Plan of the Distribution Systemization Promotion Council**

2.20 The United States notes that in its Seventh Interim Report, the Distribution Committee proposed the creation of the Distribution Systemization Promotion Council in order to "set the basic direction for systemizing distribution activities". In 1970, MITI established the Council and in 1971, the Council published the "Basic Plan for the Systemization of Distribution" (the "Basic Plan").³⁷ The Council described the Basic Plan as representing "the result of government and the private sector joining forces to consider the basic direction and goals for the systemization of distribution in Japan, and the means

³⁷US Ex. 71-10 and Japan Ex. B-18.

of realizing these goals, with the year 1975 set as the tentative target date for completion."³⁸ The Council affirmed the "government and the private sector will make a wholehearted effort to realize this basic plan."³⁹

2.21 According to the United States, MITI's introduction to the Basic Plan stated that among the various problems facing the trade and industrial policy in the 1970s, "the modernization of Japanese distribution is urgent from the standpoint of achieving balanced development of the Japanese economy, as well as from the standpoint of consumer price "(counter)measures" and capital liberalization "(counter)measures".⁴⁰ The introduction further acknowledged that the Japanese economy had grown tremendously, and the question of how best to supply consumers with goods produced in large quantities was still an issue. Consequently, the Basic Plan acknowledged that the role of distribution, which connects production with consumption, was very important. The Basic Plan noted that since distribution activity involves numerous enterprises, the close interconnections between these enterprises must be given careful attention. As a result, it was necessary to regard the entire distribution process from production to consumption as a single system, and to effect a comprehensive increase in the efficiency of this system. The Committee which produced the Basic Plan indicated that with this plan, MITI had decided to make every effort toward the fulfilment of distribution systemization policies.

2.22 The United States further notes that the Basic Plan determined that there was a need for standardizing transaction terms to secure effective and fair competition and to reorganize market conditions generally, but also more specifically in connection with capital liberalization to "prevent disruption of the [established] order of trade by foreign capital-affiliated firms, which have enormous strength."⁴¹

(e) 1975 Manual of the Distribution Systemization Development Centre

2.23 The United States notes that the Distribution Systemization Development Center⁴² was established with MITI funding in 1972 in order to facilitate the work of the Distribution Systemization Promotion Council and was delegated the task of working with industry to produce various "Systemization Manuals" for specific industries. The Center was created pursuant to the Distribution Systemization Promotion Council's 1971 Basic Plan. In 1975, it published the "Manual for Systemization of Distribution by Industry: Camera and Film" (the 1975 "Manual").⁴³

2.24 The 1975 Manual was prepared in collaboration with industry groups, camera manufacturers, film manufacturers, camera and film wholesalers, camera and film retailers, and camera and film industry publishers. The Center acknowledged that as the economic environment grew worse as a result of inflation and liberalization, the systemization of distribution activities had become an issue of critical importance.

³⁸Foreword of the Basic Plan, US Ex. 71-10. **Japan** translates this quote from the foreword as follows: "the result of an investigation of the public and private sectors for the purpose of realizing a means to achieving the goal of pointing our national economy in the direction of distribution systemization by the target year of 1975." Foreword of the Basic Plan, Japan Ex. B-18.

³⁹Foreword of the Basic Plan, US Ex. 71-10. **Japan** translates this quote from the foreword as follows: "public and private sectors put forth their combined effort to realize this basic plan." Foreword of the Basic Plan, Japan Ex. B-18.

⁴⁰Basic Plan, Cover Note by Enterprise Bureau Chief, MITI, August 1971. US Ex. 71-10. **Japan** translates this quote from the cover note as follows: "... [were] urgent issues from balanced regional economic development to measures to deal with high prices for consumers, to measures for capital liberalization." Basic Plan, Cover Note by Business Bureau Chief, MITI, August 1971, Japan Ex. B-18.

⁴¹US Ex. 71-10, p. 10.

⁴²Japan translates the name of this institute as "Distribution System Research Institute".

⁴³Manual for the Systemization of Distribution by Industry, US Ex. 75-5. **Japan** contends that the Institute submitted the 1975 Manual to MITI only for internal use of MITI.

"Although Japan has a monopolistic position in high-quality cameras, the future camera and film industries must not be complacent with their monopolistic or oligopolistic position within Japan.

Therefore, strengthening the constitution of the camera and film industry is a serious issue that must be addressed immediately against the background of today's chronic inflation and intensifying conditions of international competition."⁴⁴

The Center indicated that the development of this Manual was one part of MITI's policy to actively develop effective policies related to the systemization of distribution activities. The Manual indicated that distribution systemization is not grounded in the independent profit notions of manufacturers, wholesalers and retailers engaged in distribution activities, but must emphasize the establishment of an integrated system designed to reduce the overall distribution cost required for products to reach the final consumer.

2.25 Thereafter, the Photosensitive Materials Committee of the Distribution System Promotion Council was established for the Systemization of Distribution by Industry (Camera-Film). The Committee was charged with the responsibility of promoting information ties and physical integration of distribution facilities. The membership included representatives from all levels of Japanese photographic film and paper distribution (each of the four domestic manufacturers, the photospecialty wholesalers association, the photofinishing laboratory association, and the photospecialty retailers association), an official from the Distribution System Development Center. An official from the MITI Chemical Industry Division observed the Committee's proceedings. The Committee produced the "Distribution Facilities Basic Plan,"⁴⁵ which was intended to improve distribution in response to "liberalization" and outlined measures to promote joint distribution facilities between Japanese manufacturers and distributors.

(f) Large Stores Law

2.26 A principal focus of the US complaint is the Large Scale Retail Store Law ("Large Stores Law") which was passed by the Japanese Diet on 1 October 1973 and entered into force on 1 March 1974.⁴⁶ The provisions of the Large Stores Law and its evolution over time are discussed in detail in Section V.B. This law was preceded by the Department Stores Law (1956),⁴⁷ which required retailers wanting to open a large store with floor space in excess of 1,500 square meters, and retailers with such stores wanting to open a new store regardless of floor size, to obtain a permit from MITI. Because the Department Store Law process allowed retailers to circumvent its restrictions by creating legal identities for separate sales floors that were below that law's threshold, the Large Stores Law was enacted close the loophole. The Large Stores Law regulates the opening of all large store structures (where more than one retailer may operate) and the opening and operation of all retailers (e.g., grocery stores, discount stores, and department stores) operating in such structures, through a notification system. When originally enacted, it only regulated stores with floor space in excess of 1,500 square meters.

2.27 The Large Stores Law was revised in 1979 (amended on 15 November 1978 with an effective date of 14 May 1979).⁴⁸ Through these amendments, two main changes were effected: (1) the threshold for stores covered by the Law was lowered from 1,500 square meters to 500 square meters, and (2) large stores were divided into two classes: Class I stores (1,500 square meters and above) under MITI's jurisdiction, and Class II stores (500 up to 1,500 square meters) under the jurisdiction of prefectural

⁴⁴1975 Manual, pp. 27-28, US Ex. 75-5.

⁴⁵US Ex. 76-2.

⁴⁶US Ex. 74-4 and Japan C-1.

⁴⁷US Ex. 56-2 and Japan Ex. C-3.

⁴⁸US Ex. 78-1.

governors. This dividing line has been moved up to 3,000 square meters (or 6,000 square meters in designated large cities) since 1992.

2.28 The Large Stores Law currently includes the following procedures: parties intending to build or open a large scale retail store must submit a notification including the proposed floor area of the store and planned opening date at least 12 months before the proposed completion and opening of the new store or expanded retail store to the appropriate authority (MITI or prefectural governor) (Article 3 notification). The appropriate authority will then issue a notice as to whether the store will be subject to the procedures under the Large Stores Law. The retailer may not commence business until seven months after this notice. Within four months after filing this initial notification, the plans must be explained to MITI and prefectural authorities, the local Chamber of Commerce and Industry, (or Commerce and Industry Association) and local retailers or their associations and consumers ("local explanation"/"public briefing"⁴⁹). At least five months before the opening of the store, the retailer must submit a notification (Article 5 notification) to the appropriate authority, who will determine whether the proposed store poses a probability of a significant effect on nearby small and medium business retail activities, (since 1994, stores with retail space of no more than 1,000 square meters in principle have been deemed to have no such probability), and may recommend that the store reduce its sales floor space, and/or delay its opening date. If the appropriate authority determines that elements of the proposed plan pose a probability of significant effect, it refers the items to the national (in the case of Class I stores) or prefectural (in the case of Class II stores) Large Store Council, which is an official advisory body to MITI and the prefectural governors, respectively. The Council must submit the results of its deliberations to the appropriate authority. After receiving the Large Store Council's views, the appropriate authority may submit recommendations to the persons proposing the large scale store, among other things, delay the store's opening or reduce its floor space. If the store does not follow the recommendation, MITI or the prefectural governors may order it to do so.

2.29 In 1982 MITI instituted, through Directive No. 36,⁵⁰ a "prior explanation" requirement to precede the builder's Article 3 Notification, which obligated the notifier to provide local retailers with an explanation before submitting its Article 3 Notification. This directive was revoked in 1992.

(g) Japan Development Bank and the Small and Medium-Sized Enterprise Agency

2.30 The Japan Development Bank (JDB) is a quasi-governmental financial institution, and the Small and Medium-Sized Enterprise Agency (SMEA) is one of the agencies of MITI.⁵¹ The JDB and SMEA provide subsidized financing to industry.⁵² For example, JDB provided funding for Konica to establish joint distribution facilities with several independent wholesalers.

3. JFTC

2.31 The US submissions also focus attention on the Japan Fair Trade Commission (JFTC). The JFTC is an independent Japanese Government agency. The JFTC has responsibility for enforcement of the Antimonopoly Law and the Premiums Law. For purposes of this dispute, the most important provisions of those laws and measures taken under them are the following:

⁴⁹See translation issue 14.

⁵⁰Japan C-16 and US Ex. 82-2.

⁵¹US Ex. 67-11, US Ex. 12, and US Ex. 70.

⁵²Takashi Yokokura, Chapter 20 Small and Medium Enterprise, Industry Policy of Japan Edited by Ryutaro Komiya, Masahiro Okuni, and Kotaro Suzumura, 1988, p. 521 (US Ex. 59) and Chapter 11: The Development of New Policy Measures, MITI History, Volume 15, 31 May 1991, pp. 1-2, US Ex. 70.

(a) **Antimonopoly Law**

(i) **JFTC Rule No. 1 under Article 6 of the Antimonopoly Law**

2.32 Article 6 of the Antimonopoly Law of 1947⁵³ provides:

"(1) No entrepreneur shall enter into an international agreement or an international contract which contains such matters as constitute unreasonable restraint of trade or unfair trade practices.

(2) An entrepreneur who has entered into an international agreement or an international contract (limited to only such an agreement or contract that belongs to the types which are prescribed by the rules of the [JFTC] as tending to contain such matters as constitute unreasonable restraint of trade or unfair trade practices) shall, in accordance with the Rules of the [JFTC], file a notification thereof with the [JFTC], accompanied by a copy of the said agreement or contract (in the case of an oral agreement or contract, a document describing the contents thereof), within thirty days as from the conclusion of such agreement or contract".

2.33 JFTC Rule No. 1⁵⁴ under Antimonopoly Law Article 6.2 requires notification to the JFTC of the conclusion of an international agreement or an international contract in certain specified areas, including "comprehensive sales agreements"⁵⁵ or "sole distributorship contracts"⁵⁶. A bill to repeal the international contract notification requirement was introduced in March 1997 to the Diet. **Japan** submits that the bill was enacted in June 1997, amending Article 6(2) of the Antimonopoly Law, and simultaneously abolishing JFTC Rule No. 1.

(ii) **JFTC Notification 34 of 1971 (open lotteries)**

2.34 JFTC Notification 34 of the JFTC on Unfair Trade Practices Offering Economic Benefits by Means of Advertising Lotteries, etc. of 2 July 1971 ("JFTC Notification 34 of 1971"), also referred to as notification on "open" prizes.⁵⁷ This Notification designates, inter alia, the following as unfair trade practices pursuant to Article 2, paragraph 7, of the Antimonopoly Law when offering economic benefits by means of advertising lotteries, etc. :

"Activities in which businesses who produce ... or sell the products listed in attached Table 1 ... , as a means to attract consumers, select people from among general consumers through advertisements and offer them excessive amounts of cash, goods or other kinds of economic benefits in light of normal business practices ...".⁵⁸

According to the **United States**, Table 1 attached to this Notification includes "photosensitive materials". Photosensitive materials were among a number of products explicitly identified by the JFTC as subject to this notification. Secretary General Directive No. 5 of 2 July 1971 provides for "Guidelines Pertaining to the Designation of Unfair Trade Practices Offering Economic Benefits by Means of Advertising Lotteries, etc". These guidelines provide, inter alia, that:

⁵³The Law Concerning Prohibition of Private Monopoly and Maintenance of Fair Trade Law No. 88 of 1947, US Ex. 47-1.

⁵⁴US Ex. 71-6.

⁵⁵US translation.

⁵⁶Japanese translation.

⁵⁷Antimonopoly Law: related Laws and Regulations, 28 June 1995, pp. 85-88, exhibit submitted by the United States by letter to the Panel of 6 August 1997.

⁵⁸Ibid., provisional translation, p. 85.

"Excessive amounts of cash, goods, or other kinds of economic benefits in light of normal business practices' (hereafter referred to as "excessive economic benefits") stipulated by [JFTC Notification 34 of 1971] should be dealt with in the following manner:

...

c. An economic benefit exceeding 1,000,000 yen ... is considered to be an excessive benefit".⁵⁹

Japan submits that as of 1 April 1996, this ceiling of 1,000,000 yen has been increased to 10,000,000 yen and that no limit has ever been set to the total amount of prizes.

(iii) JFTC Notification 15 of 1982

2.35 Antimonopoly Law Article 2.9 sets forth categories of "unfair trade practices" and authorizes the JFTC to designate impermissible practices under the law. In 1982, the JFTC issued Notification No. 15, which revised and expanded the categories of unfair trade practices from twelve to sixteen. The following is prohibited pursuant to the respective designations:

Unjust Low Price Sales:

6. Without proper justification, supplying a commodity or service continuously at a price which is excessively below cost incurred in the said supply, or otherwise unjustly supplying a commodity or service at a low price, thereby tending to cause difficulties to the business activities of other businesses.

...

Deceptive Customer Inducement:

8. Unjustly inducing customers of a competitor to deal with oneself by causing them to misunderstand that the substance of a commodity or service supplied by oneself, or terms of the transaction, or other matters relating to such transaction are much better or much more favourable than the actual one or than those relating to the competitor.

Customer Inducement by Unjust Benefits:

9. Inducing customers of a competitor to deal with oneself by offering unjust benefits in the light of normal business practices.

(b) Premiums Law

2.36 Pursuant to Articles 3 and 4 of the Premiums Law⁶⁰, the JFTC issues notifications interpreting the Premiums Law in respect of unlawful premiums and representations. The United States lists Notifications 5, 17 and 34 (open lotteries) as specific measures that it is challenging in this dispute. It also refers in its submissions to Notifications 3 and 34 (origin). Under Article 10(1) of the Premiums Law, the JFTC may approve fair competition codes for specific industries. The 1987 Retailers Code, discussed in Section II.B.4.(b) below, is an example of such a code.

2.37 The JFTC has explained that, as used in its notifications, "premiums ... refer to products, cash, marketable securities, entertainment, or other economic benefits which are given in connection with

⁵⁹Ibid., pp. 86-87.

⁶⁰US Ex. 62-6; Japan Ex. D-1.

a transaction involving a commodity or service.⁶¹ Article 3 of the Premiums Law gives the criteria for restrictions on premiums. It provides:

"The JFTC may, when it finds that it is necessary to prevent unfair inducement of customers, limit either the maximum value of a premium or the aggregate amount of premiums, the kind of premiums or methods of offering of premium or any other matter relating thereto, or may prohibit the offering of a premium".

2.38 Article 2 of the Premiums Law defines "representations" to mean "advertisements or any other representations which a business makes or uses as means of inducement of customers, with respect to the substance of the commodity or service which he supplies or the terms of the sale or any other matter concerning the transaction, and which are designated by the Fair Trade Commission as such". Article 4 of the Premiums Law proscribes the use of

(i) "any representation by which the quality, standard or any other matter relating to the substance of a commodity or service *shall lead the general consumer to believe that it is*⁶² much better than the actual one or than that of other businesses who are in a competitive relationship with the business concerned, and thereby which is found likely to induce customers unjustly and to impede fair competition;" or

(ii) "any representation by which price or any other terms of transaction of a commodity or service will be misunderstood by consumers in general to be much more favourable to the customer than the actual one or than those of other businesses who are in a competitive relationship with the business concerned, and thereby which is found likely to induce customers unjustly and to impede fair competition."

2.39 Article 6 of the Premiums Law authorizes the JFTC to instruct violators to "cease and desist" or to "take the measures necessary to prevent the recurrence of the said act." Article 9 of the Premiums Law gives the prefectural governments enforcement authority, including the power to instruct violators to "cease and desist" and to publish findings of violations.

2.40 Article 10 of the Premiums Law, dealing with fair competition codes, provides:

"(1) Businesses or a trade association may, upon obtaining authorization from the Fair Trade Commission in accordance with the Rules of the Fair Trade Commission, with respect to matters relating to premiums or representations, conclude or establish an agreement or a code, aiming at prevention of unjust inducement of customers and maintaining fair competition. The same shall apply in the event alterations thereto are attempted.

(2) The Fair Trade Commission, unless it finds that an agreement or a code under the preceding section (hereinafter referred to as "fair competition code") meets each of the following paragraphs, shall not grant authorization under the preceding subsection:

- (i) That it is appropriate to prevent unjust inducement of customers and to maintain fair competition;
- (ii) That it is not likely unreasonably to impede the interests of some consumers in general or the related businesses;

⁶¹ FTC/Japan, Views: Information and Opinion from the Fair Trade Commission, No.2, April 1988, US Ex. 88-3, p. 15.

⁶² **Japan** translates the *italicized* words above as "will be misunderstood by consumers in general to be". See Annex on Translation Problems, translation issue 16 and the appendix thereto.

- (iii) That it is not unjustly discriminatory; and
- (iv) That it does not restrict unreasonably the participation in or withdrawal from the fair competition code".

...

(5) The provisions of Section 48 [recommendation, recommendation decision] and Section 49 [initiation of hearing procedures], Section 67(1) [urgent injunction] and Section 73 [accusation] of the Act Concerning Prohibition of Private Monopoly and Maintenance of Fair Trade shall not apply to the fair competition code that has been authorized under Subsection (1), and to such acts of entrepreneurs or a trade association as have been done in accordance therewith".

(i) JFTC Notification of 1965

2.41 The JFTC issued a Notification on 15 October 1965 entitled "Restrictions on Premium Offers in the Camera Industry." The notification provided that "[t]hose who engage in the manufacture or sale of cameras or related products cannot offer premiums to general consumers" or "to those who engage in the sale of cameras and related products."⁶³

(ii) JFTC Notification 17 of 1967

2.42 JFTC Notification 17 on Restriction on Premium Offers to Businesses of 10 May 1967 ("JFTC Notification 17").⁶⁴ This Notification was made in accordance with Article 3 of the Premiums Law. It provides essentially the following:

"Businesses ... who manufacture (including process, hereinafter the same) the products listed in the attached table or businesses who sell such products shall not offer premiums to businesses who purchase and sell the products involved in such manufacture or sale, or who use the products to supply services to general consumers (hereinafter referred to as "other party business"), as a means of inducing the other party business to begin to transact such products, or on the condition that the other party business's transaction amount or such other transaction condition satisfy certain criteria which the [first] business has established. Provided, however, that the preceding provisions shall not apply to cases of premium offers which are within the annual limit of 100,000 yen or less per one other party business, and which are found reasonable in the light of normal business practices".

The table attached to this Notification includes "photographic materials". The parties agree that Notification 17 was abolished in April 1996. However, according to the **United States**, premiums from manufacturers to wholesalers are still subject to JFTC Designation 9 of JFTC Notification 15 of 1982.⁶⁵ This provision governs the use of "unjust inducements" under the Antimonopoly Law and prohibits premium offers in excess of "normal business practice". **Japan** contends that Designation 9 has not been listed in the US panel request and thus is not properly before the Panel.

⁶³Otsuka Noritami, Japan Fair Trade Commission, Trade Department, Recent Activities Concerning Premiums Law, Kosei Torihiki, No. 182, November 1965, p. 15-18, US Ex. 65-5.

⁶⁴US Ex. 67-4, Japan Ex. D-42 (provisional translation).

⁶⁵US Ex. 82-6.

(iii) JFTC Notification 34 of 1973 (origin)

2.43 JFTC Notification 34 on Misleading Representations Concerning Country of Origin of Goods of 16 October 1973 ("JFTC Notification 34 of 1973").⁶⁶ This Notification was made in accordance with Article 4 of the Premiums Law. It provides essentially the following:

"Representations provided for in the following sections which, when applied to domestically made goods, are found to make it difficult for general consumers to distinguish the goods as domestically made:

- (i) Representations comprising the name of a foreign country, the name of a place in a foreign country, the flag or crest of a foreign country, or any other similar representations;
- (ii) Representations comprising a full name, title, or trade mark of any foreign business or designer; or
- (iii) Representations in which all or a principal part of the literal description is made in foreign letters.

Representations provided for in the following sections which, when applied to foreign-made goods, are found to make it difficult for general consumers to distinguish the goods as made in the foreign country in question:

- (i) Representations comprising the name of a country, the name of a place in a country, a flag or crest of a country other than the country of origin of the goods, or other similar representations;
- (ii) Representations comprising a full name, title, or trade mark of a business or designer in a country other than the country of origin of the goods;
- (iii) Representations in which all or a principal part of the literal description is made in Japanese letters".

According to the **United States**, the JFTC Application Standards for "Misleading Representations Concerning Country of Origin of Goods" of 16 October 1973 provide JFTC interpretation of the provisions of Notification 34 on origin of goods.⁶⁷ The United States placed particular emphasis on the following aspects of the guidelines: Paragraph two permits representations referring to foreign nations or places to be made in connection with Japanese products if it is "obviously understood" that the business involved is a Japanese firm. Paragraph three provides that domestic products may be identified with a foreign name, e.g., "French bread," if "clearly not to imply that the country of origin of the goods in question is a foreign country." Paragraph six allows domestic products to use:

- (i) Representations comprising the name of or trade mark of a Japanese business written in foreign letters (including Romanized Japanese), which are found to be clearly distinguished by general consumers as those which are applied to domestically made goods;
- (ii) Representations which are allowed by law to be used as descriptions for general consumers instead of Japanese (e.g., "All Wool," "Stainless Steel," etc.);
- (iii) Representations which are accepted by general consumers as Japanese by virtue of general business practices (e.g., "size," "price," etc.); and
- (iv) Representations which comprise foreign letters, but where it is obvious that the said letters are used only as patterns, ornaments and the like, and will not

⁶⁶US Ex. 73-5, Japan Ex. D-53 (provisional translation).

⁶⁷See US Ex. 73-5.

imply that the country of origin of the goods is a foreign country (e.g., the c[l]ippings from English-language magazines used as patterns on carrier bags).

According to the United States, paragraph seven provides several ways that goods may indicate that they were made in Japan, including simply identifying the name of the manufacturer in Japanese or identifying the name of the manufacturer in another language with the location of production.

(iv) JFTC Notification 3 of 1977

2.44 JFTC Notification 3 on Restriction on Premium Offers by Prize Competition of 1 March 1977 ("JFTC Notification 3"), also referred to as notification on "closed" prizes.⁶⁸ This Notification was made in accordance with Article 3 of the Premiums Law. It provides essentially the following:

"2. The maximum value of premiums offered by prize competition shall not exceed the value in accordance with each category provided for in the following paragraphs:

- (i) In the case where the transaction value involved in the premium offer by prize competition is less than 500 yen: 20 times of the transactions value;
- (ii) In the case where the transaction value is not less than 500 yen and below 50,000 yen: 10,000 yen;
- (iii) In the case where the transaction value is not less than 50,000 yen and below 100,000 yen: 30,000 yen; or
- (iv) In the case where the transaction value is not less than 100,000 yen: 50,000 yen.

3. The aggregate of the premiums offered by prize competition in one scheme shall not exceed 2 per cent of the estimated total amount of transactions involved in that scheme.

4. Irrespective of the preceding two Clauses, in any one of the cases provided for in the following sections, the maximum value offered by prize competition may amount to 200,000 yen and the aggregate of the premiums offered by prize competition in one scheme may amount to 3 percent of the estimated total value of transactions involved in that scheme. However, these limits will not be applied to the case where they unjustly constrain the participation of other businesses:

- (i) In the case where a considerable number of retailers or service suppliers in a certain district carry out a joint scheme;
- (ii) In the case where a considerable number of retailers or service suppliers located in a shopping area carry out premium offers in a joint scheme; However, the foregoing shall apply only to cases where the premium offers are carried out during the seasons such as "chugen" [midyear] and end of year, three times a year at most and below the period of 70 days in total a year; or
- (iii) In the case where a considerable number of businesses in a certain industry within a certain district carry out a scheme jointly".

On 16 February 1996, the JFTC amended JFTC Notification 3 as follows:

"Section 2 of the Notification is amended as follows:

⁶⁸US Ex. 77-1, Japan Ex. D-33 (provisional translation).

2. The maximum amount of premiums offered by prizes shall not exceed twenty times of the amount of transaction to which the premium offer is related, provided that when the amount exceeds 100,000 yen, it will be limited to 100,000 yen.

In Section [4], the "200,000 yen" shall be replaced by "300,000 yen".⁶⁹

(v) JFTC Notification 5 of 1977

2.45 JFTC Notification 5 on Restriction on Premium Offers to General Consumers of 1 March 1977 ("JFTC Notification 5").⁷⁰ This Notification was made in accordance with Article 3 of the Premiums Law. It has been amended by JFTC Notification 2 of 16 February 1996 (which removed the ceiling of 50,000 yen for premiums to all purchasers). It provides essentially the following:

"1. The value of a premium offered to general consumers, excluding those by lotteries or prize competition ..., shall be within 10 percent of the transaction value involved in the premium offer (provided that if the amount is less than 100 yen, the limit shall be 100 yen), and which is found reasonable in the light of normal business practices".

(c) JFTC guidance

(i) 1981 JFTC guidance on dispatched employees

2.46 Guidance provided by the JFTC in recommending the establishment of rules on the use of dispatched employees reflected in an article by Kosugi Misao (an official of the Executive Office of the JFTC) entitled "The Status of Distribution of Cameras" ("JFTC guidance on the use of dispatched employees").⁷¹ The relevant part of the article by Kosugi Misao states the following regarding personnel dispatched to specified volume sales stores:

"The JFTC is issuing guidance to the camera, photographic accessories, colour photo laboratories and related industries to examine the use of self-regulating measures with respect to the permanent dispatch of sales people so as not to go too far as manufacturers' sales promotion methods or as acts based on the buying power of volume sales stores".⁷²

(ii) 1983 JFTC guidance on advertising rules

2.47 Guidance provided by the JFTC in recommending the establishment of rules on dumping and loss-leader advertising reflected in an article in Zenren Tsuho of May 1983 quoting from a conference speech given by Yamada Akio (Director of the Premiums and Representations Guidance Division of the JFTC).⁷³ Yamada Akio is stated to have said, inter alia, the following:

"In any case, it goes without saying that rule abiding sales practices and fair competition must be established. Fortunately, the photo industry has its "self-regulating standards for normalizing trade". Nevertheless, it is of critical importance to develop rules one by one against dumping and loss-leader advertising. With the regard to loss-leader

⁶⁹JFTC Notification 1, Kanpo (Official Gazette) of 16 February 1996, translation, Japan Ex. D-30, p. 2.

⁷⁰Japan Ex. D-32 (provisional translation).

⁷¹Kosei Torihiki, March 1982, No. 377, p.45-49, translation, US Ex. 82-3.

⁷²Ibid., p. 8.

⁷³Zenren Tsuho, May 1983, pp. 14 ff, translation, US Ex. 83-9.

advertising, if the photo industry will clarify what the problems are, how we should apply the law will become clear".⁷⁴

4. COUNCILS AND ASSOCIATIONS

(a) Fair Trade Promotion Council

2.48 The Fair Trade Promotion Council was established by the national photographic industry on 23 December 1982.⁷⁵ According to the Articles of Association of the Fair Trade Promotion Council, the Council, inter alia, establishes fair transaction order in the photography industry and promotes and enforces the 1982 Self-Regulating Measures described below. It also enacted the 1984 Self-Regulating Standards, described below.

(i) 1982 Self-Regulation Measures (dispatch of employees and promotional money)

2.49 Self-Regulating Measures Regarding Making Business Dealings with Trading Partners Fair, enacted by the photographic industry and published on 22 June 1982 ("1982 Self-Regulating Measures").⁷⁶ For the US claim, the relevant parts thereof relate to self-regulating standards concerning the dispatch of employees by manufacturers or wholesalers to retailers for the purpose of sales promotion or other sales activities and the extent to which suppliers may contribute to retail marketing campaigns:

[1] Self-regulating standards concerning the dispatch of employees:

"(1-1) It may be proper to dispatch employees in the following cases which would directly help to promote the sales of the goods handled by the supplier and contribute to his or her profit:

...

Accordingly, the following shall not occur:

Causing the dispatched employee to be mainly engaged in the sales promotion, physical inventory, or other activities that pertain to goods other than those handled by the supplier.

(1-2) Other general retailers shall not be treated in a discriminatory manner.

(1-3) The employee shall be dispatched under mutual agreement.

Accordingly, the following things shall not occur:

[1] The supplier shall not dispatch his or her employees out of the necessity of continuing trade with the retailer.

[2] Retailers shall not coerce suppliers to dispatch the employees by recourse to words or actions akin to a refusal to deal.

[3] Retailers shall not supplement an employee shortage with dispatched employees (permanent dispatch).

...

⁷⁴Ibid., p. 2. **Japan** contested the correctness of this translation. See translation issue 22.

⁷⁵Articles of Association, 23 December 1982, Section 2 "Responsibilities", US Ex. 83-3, pp. 2 ff.

⁷⁶Camera Times, 22 June 1982, pp.3 ff., US Ex. 82-8, see translation issue 23.

- (1-4) Employees shall be dispatched in those other cases where approval from the Fair Trade Promotion Council has been obtained".⁷⁷

[2] Self-regulating standards on promotional money and contribution:

- (2-1) It may be proper to make a contribution to activities which directly assist the sales promotion of the goods handled by the supplier and that would contribute to his or her profit.

Accordingly, the following shall not occur:

- [1] [The retailer] shall not demand a contribution for expenses that are not directly related to the sales promotion, brand advertisement, etc. of the goods handled by the supplier.

- (2-2) It may be proper to make a contribution if other general retailers are not treated in a discriminatory manner.

- (2-3) It may be proper to make a contribution if mutual agreement is reached.

Accordingly, the following shall not occur:

- [1] [Retailers] shall not demand contribution without prior agreement as to the basis and use of the contribution even if the contemplated activity is considered to contribute to the profit of the supplier.

- [2] [Retailers] shall not change the amount or use of the contribution unilaterally without the consent of the supplier.

- [3] [Retailers] shall not unilaterally offset the supplier's account receivable against the contribution without the consent of the supplier.⁷⁸

(ii) 1984 Self-Regulating Standards (developing fees)

2.50 The Self-Regulating Standards Regarding Representation of Developing Fees for Colour Negative Film were enacted by the Fair Trade Promotion Council on 15 May 1984 ("1984 Self-Regulating Standards").⁷⁹ The representation standard is defined as follows:

"... businesses should properly list fees such as the developing fee of colour film and should not make representations that might mislead the general consumer or possibly lead them to have excessive expectations. This standard should not be used to limit or restrain businesses freedom to set fees".⁸⁰

The 1984 Self-Regulating Standards also set out the method of representation for printing fees, developing fees and finishing time. They also provide that the Fair Trade Promotion Council shall conduct investigations and provide guidance on the operation of the standards if necessary.⁸¹

⁷⁷Ibid., translation, US Ex. 82-8, pp. 1-2.

⁷⁸Camera Times, 22 June 1982, pp. 3 ff., US Ex. 82-8, see translation issue 23.

⁷⁹Translation, US Ex. 84-4.

⁸⁰Ibid., p. 2.

⁸¹Ibid., p. 3.

(b) Retailers Council and 1987 Retailers Code

2.51 On 31 March 1987, acting pursuant to Article 10(1) of the Premiums Law, the JFTC approved the Fair Competition Code Regarding Representations in the Camera and Related Products⁸²/Camera Category⁸³ Retailers Industry ("1987 Retailers Code") and its enforcement body the Cameras and Related Products/Camera Category Retailers Industry Fair Trade Council ("Retailers Council").⁸⁴ The objective of the 1987 Retailers Code is "to protect the general consumers' appropriate product selection, prevent the unfair inducement of customers, and thereby to secure fair competition".⁸⁵ The Code, inter alia, provides for requisite representations for store fronts and in fliers, including identification of the country of origin of imported goods; it imposes standards for the representation of dual prices, for the use of special expressions and comparative representations; and prohibits misleading representation and loss-leader advertisement. The Code also identifies the powers of the Council with respect to investigating suspected violations of the provisions of the Code and the penalties that may be imposed for such violations.

(c) Chambers of Commerce and Industry

2.52 According to the United States, Japanese Chambers of Commerce and Industry are established pursuant to the Chamber of Commerce and Industry Law, which allows for the creation of local bodies under the control and oversight of MITI. Chambers of Commerce and Industry are delegated the responsibility to "conduct administrative matters commissioned by administrative agencies", such as MITI.⁸⁶ MITI also has the authority to "investigate" the on-going activities of the Chambers of Commerce and Industry.⁸⁷

⁸²US translation of "kamera-rui". See translation issue 17.

⁸³Japan's translation of "kamera-rui". See translation issue 17.

⁸⁴Kanpo (Official Gazette), 11 April 1987, pp. 1-3, translation, US Ex. 87-1, Japan Ex. D-66.

⁸⁵Id., p. 1.

⁸⁶Article 9-17 of the Chamber of Commerce Law, Law No. 143, 1 August 1953.

⁸⁷The investigatory activity is defined in the Chamber of Commerce Law to include requiring the submission of an annual financial statement to MITI (Article 57), and MITI authority to audit the Chambers of Commerce (Article 58), as well as to dissolve a Chamber of Commerce (Article 59 of the Chamber of Commerce Law). MITI has the authority over Chambers of Commerce to accept or deny the permit of a new Chamber. Article 5-19 of the MITI Establishment Law, US Ex. 52-2.

III. SUMMARY OF CLAIMS AND PROCEDURAL OBJECTIONS

A. EVOLUTION OF THE US CLAIMS

3.1 This section details the evolution of the US claims, using where appropriate the short titles of the various measures as defined in the foregoing section. The US request for consultations identified the following Japanese measures as being at issue:

- a. liberalization countermeasures;⁸⁸
- b. distribution guidelines and related measures;
- c. the Large Stores Law;
- d. the Premiums Law;
- e. measures regarding dispatched employees;
- f. the application of the Law to Promote Business Reform for Specified Industries;
- g. the Ministry of International Trade and Industry Establishment Law;
- h. and related legislation, regulations, and administrative measures.

3.2 The US request for the establishment of a panel identified the following Japanese measures as being at issue:

- a. liberalization countermeasures;
- b. distribution measures, such as, but not limited to, the cabinet decision, administrative guidance, and other measures listed in Attachment A;
- c.
 - i. the Large Stores Law;
 - ii. Special Measures for the Adjustment of Retail Business; No. 155 of 1959 (*Shocho Ho*);
- d. the Premiums Law;
- e. measures regarding dispatched employees pursuant to the Antimonopoly Law;
- f. the Law Concerning Enterprise Reform for Specified Industries, No. 61 of 1995;
- g. the Ministry of International Trade and Industry Establishment Law, No. 275 of 1952;
- h. and related measures.

Attachment A contained the following list of distribution measures:

- i. MITI, "Administrative Guidance to Promote Rationalization of Distribution System", 1966;
- ii. 1967 Cabinet Decision;
- iii. Distribution Committee Seventh Interim Report;
- iv. 1969 Survey;
- v. 1970 Guidelines;
- vi. MITI, "Business Bureau Report on Film Prices", 1970;
- vii. 1971 Basic Plan;
- viii. 1975 Manual;
- ix. 1990 Guidelines;
- x. MITI and the Small and Medium Enterprises Agency, "Distribution Vision for the 21st Century", 1995 (and earlier versions for the 1970s, 1980s, and 1990s);
- xi. Photo Industry Distribution Information Systemization Council [Kyogikai], "Comprehensive Manual for Photo Distribution Industry Distribution Information Systemization", 1996 (and 1989, 1990, 1991, and 1992 versions);
- xii. Other related measures, including guidelines.

⁸⁸ Japan disagrees with this translation of the Japanese word *taisaku*. See translation issue 1.

3.3 In response to a question by the Panel at the first substantive meeting, the United States submitted the following list of specific "liberalization countermeasures" which are subject to claims under Articles III, X:1 and XXIII:1(b) of GATT. The list is divided into three categories: distribution countermeasures; large stores law; and promotion countermeasures.

3.4 The following measures were included in the list of distribution countermeasures:

- (1) 1967 Cabinet Decision
- (2)* JFTC Notification 17
- (3)* Distribution Committee Sixth Interim Report
- (4) Distribution Committee Seventh Interim Report
- (5) 1969 Survey on Transaction Terms
- (6) 1970 Guidelines for Rationalizing Terms of Trade for Photographic Film
- (7)* International Contract Notification under the Antimonopoly Law and JFTC Rule 1
- (8) 1971 Basic Plan
- (9) 1975 Manual
- (10)* 1976 JDB funding for Konica's wholesalers
- (11)* 1977 SMEA funding for photoprocessing laboratories.

3.5 The following measures were included under the heading "Large Stores Law":

- (12) Large Stores Law and related regulations and administrative measures, including related local measures;
- (13) 1979 Diet amendment to Large Stores Law

3.6 In addition to items (1) and (2) above, the following measures were included under the heading "Premiums Law/promotion countermeasures":

- (14)* 1971 JFTC Notification 34
- (15)* 1977 JFTC Notification 5
- (16) 1981 JFTC guidance on dispatched employees
- (17) 1982 Self-Regulating Rules
- (18) 1982 Establishment of Fair Trade Promotion Council
- (19)* 1983 JFTC guidance on advertising rules
- (20) 1984 Self-Regulating Standards
- (21) JFTC approval of the 1987 Retailers Code and its enforcement body, the Retailers Fair Trade Council.

3.7 In response to another Panel question, the United States indicated that in respect of its claims under Article III:4, Article X:1 and Article XXIII:1(b) of GATT:

- a. The measures alleged to be inconsistent with Article III:4 are the "Distribution Countermeasures" listed in paragraph 3.4.
- b. The measures alleged to be inconsistent with Article X:1 are (i) unpublished enforcement actions by the JFTC and fair trade councils under the Premiums Law and relevant fair competition codes that establish or modify criteria applicable in future cases; and (ii) unpublished guidance through which the Japanese Government makes applicants for a new or expanded store under the Large Stores Law coordinate their plans with local competitors before submitting a notification for government review.

- c. The measures alleged to nullify or impair benefits within the meaning of Article XXIII:1(b) of GATT are the "Distribution Countermeasures", "Large Stores Law," and "Premiums Law/Promotion Countermeasures" listed in paragraphs 3.4-3.6.

3.8 In response to that Panel question the United States also indicated the extent to which it claimed that the individual measures listed above should be considered in conjunction with each other in determining whether Articles III and X have been violated and whether there has been a nullification or impairment of benefits under GATT within the meaning of Article XXIII:1(b). According to the United States, the distribution countermeasures work together as an organic whole to violate Article III and nullify or impair benefits within the meaning of Article XXIII:1(b). In addition, the United States takes the position that the Large Stores Law and related measures should be considered as an important measure in Japan's overall efforts to create and support manufacturer-dominated, vertically aligned distribution in Japan under the distribution countermeasures. Thus, it claims that the Large Stores Law and related measures and the distribution countermeasures in combination nullify or impair benefits under Article XXIII:1(b). The United States also claims that the promotion countermeasures as a set by themselves have nullified or impaired benefits under Article XXIII:1(b). Finally, the United States claims that the distribution countermeasures, the Large Stores Law and related measures and the promotion countermeasures, taken as three sets of measures, have also operated in combination so as to nullify or impair benefits within the meaning of Article XXIII:1(b). See Section D of Part IV and Section F of Part V for a detailed discussion of the combined effects of the three sets of measures acting in combination.

3.9 **Japan** contends that the US case is highly unusual in commencing its legal argument with "non-violation nullification or impairment" claims because such claims normally would be considered subsidiary to violation claims. To the extent that the same alleged measure gives rise to both violation and non-violation claims, panels normally do not consider non-violation issues until the alleged violations have been addressed.⁸⁹ The US allegations regarding so-called "distribution countermeasures" - i.e., alleged measures taken by the Japanese Government in the 1960s and '70s to encourage the establishment of an exclusionary market structure that impedes market access for imported film and paper - form the centrepiece of the US non-violation claims. At the same time, the US argues that these "distribution countermeasures" constitute violations of Article III national treatment obligations.⁹⁰

3.10 Japan emphasizes that only the specific measures mentioned in the foregoing US responses need to be evaluated by the Panel. In Japan's view, measures not mentioned in the US responses are outside the scope of the dispute, and need not be considered further.

B. PROCEDURAL OBJECTIONS

3.11 **Japan** requests the panel to dismiss the US claims marked with an asterisk in paragraphs 3.4-3.6 above because these "measures" were raised by the United States for the first time in its initial submission to the Panel, and had not been identified specifically in the request for the establishment of the panel.⁹¹ Japan originally objected to nine items, but the United States did not include two of them - certain

⁸⁹In prior panel decisions addressing non-violation allegations, the panels first addressed the violation claims, and then addressed non-violation claims. See e.g., Panel Report on *European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseed, and Related Animal Feed Products* ("EEC - Oilseeds"), adopted on 25 January 1990, BISD 37S/86, 126, para. 142. See also, *Working Party Report on the Australian Subsidy on Ammonium Sulphate* ("Australia - Ammonium Sulphate"), GATT/CP.4/39, adopted on 3 April 1950, BISD II/188, 192, paras. I, 12.

⁹⁰Japan notes that the US also makes Article X violation claims with respect to the Large Scale Retail Store Law and the Premiums Law.

⁹¹Japan pointed out that it had listed only those items which appeared in the "legal argument" section of the first US submission, although, in Japan's view, there were other items which are raised for the first time in the "factual background" section of the first US submission. It was Japan's understanding that those items not specifically mentioned in the "legal argument" section are not part of the US legal claims in the proceeding.

countermeasures by the Photosensitive Materials Committee of the Distribution Systemization Promotion Council and directives to strengthen the Department Stores Law - in its response to the Panel's request that it specify the measures subject to US claims. Japan later objected to an additional tenth item - 1983 Guidance on advertising rules - which the United States included in its response to the Panel's request, but which Japan contends was neither specifically identified in the panel request nor raised in the consultations. In Japan's view, the items that were not specified in the panel request should be dismissed as not being properly before this panel and vague reference to "measures, such as, but not limited to," "related measures," and "other related measures, including guidelines" in the panel request are inconsistent with Article 6.2 of the DSU, which requires the complaining party to identify the "specific measures at issue." In Japan's view, the US requests for consultations and the establishment of a panel insufficiently identified the measures in dispute. In particular, the US panel request failed to meet the specificity requirements of Article 6.2 of the DSU.

1. THE REQUEST FOR CONSULTATIONS AND THE CONSULTATIONS

3.12 Article 4.4 of the DSU reads:

"Any request for consultations shall be submitted in writing and shall give the reasons for the request, including identification of the measures at issue and an indication of the legal basis for the complaint".

3.13 Japan emphasizes that it is particularly important in this case for the United States to have specifically identified the "measures" in its panel request, because the request for consultations was overly broad and vague, and did not "identify" the measures for the purposes of Article 4.4 of the DSU, which requires the complaining party to include "identification of the matter at issue". Japan points out that the consultations themselves in this case also did not identify the specific measures. According to Japan, proper consultations are fundamental to the operation of the WTO dispute settlement procedures and the United States has often stressed the importance of matters being raised in the consultation stages prior to the panel request, e.g., arguments raised by the United States led the panel in *Norwegian Salmon* to explain that "for a claim to be properly before the panel, it had to be within the Panel's terms of reference and it had to have been identified during prior stages of the dispute settlement process".⁹² In *United States - Measures Affecting Alcoholic and Malt Beverages* ("*United States - Alcoholic Beverages*"), the United States summarized the policy rationale as:

"... consultations provide the parties an opportunity to reach a satisfactory solution to the dispute before proceeding to a panel. The party complained against might modify its practice or, alternatively, convince the complaining party of the GATT consistency of its measure, in either case avoiding the need for a panel. Furthermore, in those situations where resolution is not possible without recourse to a panel, consultations provide the defending party notice of the measure(s) complained of and the consequent opportunity to prepare adequately for the issue. Such basic due process is a fundamental element of all equitable adjudicatory systems".⁹³

3.14 The **United States** submits that consultation requests and panel requests share one common purpose, i.e., to give notice. The notice given should be increasingly more specific at each stage and the degree of specificity required should be proportional to what notice is needed to ensure the parties' meaningful participation at each stage. Article 4.4 of the DSU requires that requests for consultations include "identification of the measures at issue and an indication of the legal basis for the complaint."

⁹²Panel Report on *United States - Imposition of Anti-Dumping Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway* ("*United States - Norwegian Salmon*"), adopted on 26 April 1994, ADP/87, 100, para. 338.

⁹³Panel Report on *United States - Measures Affecting Alcoholic and Malt Beverages* ("*United States - Alcoholic Beverages*"), adopted on 19 June 1992, BISD 39S/206, 226, para. 3.2 (summary of US argument).

The specificity of the notice given by the complaining party to the responding party must be sufficient for the responding party to understand the nature of the matter alleged by the complaining party, and to prepare for the consultations so that they will be meaningful.

3.15 The United States argues that the DSU does not prescribe the specificity with which a matter must be raised and discussed in consultations. The complaining party's description of the matter should include a description of how the measures it understands to be related to the matter operate and a description of how those measures are inconsistent with the relevant WTO agreements. It is not unfair for the responding party to bear responsibility for knowing about its own interpretations or applications of its measures, particularly since those rulings and interpretations would be made under its own legal system in its own language. But the discussions should be specific enough to serve the purpose of the consultations, i.e., to give the complaining party an opportunity to explain the matter complained of, to give the responding party the opportunity to explain the basis for maintaining the measures and to provide the opportunity for the parties to reach a satisfactory adjustment of the matter before proceeding to a panel.

3.16 The United States explains as a general matter, if a party complains about the operation and effect of a given law or measure, it should not be required to discover and present in the consultations every potentially relevant amendment, regulation, directive, notice, administrative action, or judicial decision interpreting and applying that law or measure. In many countries, including the United States, the full panoply of regulations, administrative rulings, and judicial decisions regarding a particular law could fill an entire wall of bookshelves. The approach advocated by Japan would compel a complaining party to research every last volume on the shelves before requesting consultations to be sure that it could identify and mention in the consultations each ruling and interpretation that might possibly be relevant in a panel submission. Such an approach would compel the complaining party to become as knowledgeable about the measures as the responding party that promulgated and administers the measures before requesting consultations. Placing such a difficult and unnecessary burden on complaining parties would discourage Members from requesting consultations unless they had already written their first submission to the panel. Such a heavy burden is not reflected in the DSU and would impair the settlement of disputes.

3.17 **Japan** responds that the fundamental reason behind Japan's request for the dismissal of certain US claims is that the measures were not even specifically mentioned in the US panel request. Japan further explains that the DSU does not require that every interpretation or application of a measure be identified, but that it rather requires the complaining party to identify the specific measures at issue. It is Japan's view that in this case the United States, e.g., complains against certain specific notifications under the Premiums Law, such as the issue of representations, but did not disclose those specific notifications until its first submission.

3.18 The **United States** maintains that each of the measures which are subject to Japan's procedural objections was within the scope of the measures identified and described by the United States in the consultations as reflected in the statement that the United States delivered at the consultations and the US delegation's notes of the dialogue between the parties. During the consultations, the United States presented a detailed and coherent picture of the means and results of Japan's liberalization countermeasures. Japan was apprised in great detail of all the measures at issue, the factual basis for the dispute, the exact nature of the US assertions and the legal arguments that the United States considered applicable.

3.19 In **Japan's** view, the United States' argument that it presented in the consultation "a detailed coherent picture of the means and results of Japan's liberalization countermeasures" does not justify the US failure to meet the requirement under Article 6.2 of the DSU to identify the "specific measures at issue." Japan argues that the United States appears to misunderstand the notice requirement of

Article 6.2 which provides that the panel request "shall ... identify the *specific measures* at issue" and thus it requires greater specificity and detail in the request.

3.20 The **United States** contends that it has no obligation to "discover and present in the consultations every potentially relevant amendment, regulation, directive, notice, administrative action, or judicial decision interpreting and applying that law or measure."

3.21 **Japan** responds that the United States has misunderstood the Japanese argument. First, the fundamental reason behind Japan's request for the dismissal of certain US claims is that the measures were not even specifically mentioned in the US panel request. Second, the DSU does not require that every interpretation or application of a measure be identified; rather, it requires the complaining party to identify the specific measures at issue. In this case, e.g., the United States complains against certain specific notifications under the Premiums Law, such as the issue of representations, yet did not disclose those specific notifications until its first submission.

3.22 More specifically, the **United States** insists that seven of the nine measures referred to by Japan under its procedural objections form part of the broader group of government actions and policy processes that the United States categorizes as "distribution countermeasures":

- (1) Distribution Committee Sixth Interim Report;
- (2) Japan Development Bank (JDB) financing to Konica;
- (3) Small and Medium Enterprise Agency (SMEA) financing to photofinishing laboratories
- (4) Countermeasures by the Photosensitive Materials Committee of the Distribution Systemization Promotion Council;
- (5) Directives to strengthen the Department Stores Law;
- (6) International Contract Notification under the Antimonopoly Law and JFTC Rule 1;
- (7) JFTC Notification 17.

Moreover, the United States contends that three of the nine measures referred to by Japan under its procedural objections are interpretations or applications of the Premiums Law. In addition to the just-mentioned Notification 17, these are namely:

- (8) JFTC Notification 34;
- (9) JFTC Notification 5.

The United States discusses each of these measures in turn.

3.23 (1) *Distribution Committee Sixth Interim Report*: The United States submits that this report was one of a series of studies by the Council that formed the basis for distribution policy in Japan, reflecting an analysis and consensus-building process between government and the private sector. In the consultations, the United States specifically identified and described this process by the Industrial Structure Council and its series of reports. The United States stated that MITI charged the Distribution Committee of the Industrial Structure Council with devising measures for consolidating and strengthening the distribution system in anticipation of market liberalization and that MITI's instructions on how to consolidate the distribution system were set forth in a series of reports and guidelines to industry in the late 1960s and early 1970s. The United States mentioned examples of Distribution Committee reports and therefore, Japan had sufficient notice of the US concern about all of the Distribution Committee reports. The United States maintains that the Sixth Interim Report is within the scope of the "series of reports and guidelines to industry in the late 1960s and early 1970s", and "[actions by the Distribution Committee of the Industrial Structure Council ... for consolidating and strengthening the distribution system" discussed by the United States in the consultations.

(2)-(3) *JDB and SMEA Financing*: In respect of the US claims related to the JDB financing given to Konica to establish common distribution facilities with its wholesalers and the SMEA financing given to photofinishing laboratories to help align them with domestic manufacturers, in the US view, Japan was on full notice from the consultations that the United States was concerned about government financing to assist the consolidation of distributors under the domination of Japanese manufacturers. Specifically, the United States noted that the 1971 Basic Plan set forth objectives and a process for the Japanese industry to accomplish those objectives under the "systemization" policy. The United States pointed out that the Basic Plan did not rely on voluntary efforts alone, but looked for financial incentives to achieve *keiretsu*-nization [of distribution]. The United States emphasized several provisions of the Basic Plan to support this point, including the statement in the Basic Plan that "*positive support and guidance from the government will be necessary*" to carry out systemization. Based on these discussions, the United States argues that Japan had reason to expect that the United States would continue pursuing the specific ways in which Japan gave its "positive support" for wholesalers and laboratories (which also act as wholesalers) to establish or strengthen their exclusive ties with Japanese manufacturers.

(4) *"Countermeasures" by the Photosensitive Materials Committee*: The United States further contends that actions by the Photosensitive Materials Committee (Committee) of the Distribution Systemization Promotion Council (Council) also fit within the confines of the distribution countermeasures discussed by the United States in the consultations. The United States addressed in detail the actions of the Committee's parent, the Council, which authored the 1971 Basic Plan. The United States described how the Basic Plan called for the "support and guidance" of the Japanese Government to accomplish the systemization goals. The United States specifically stated that over the next several years following the Basic Plan, the Japanese Government followed up with further studies to see how its plans were being implemented and to add to or refine its guidance for consolidating the distribution structure. Such follow-up and further guidance is exactly what the Committee did and it played an important role in ensuring that Konica received subsidized financing from the Japan Development Bank to establish a joint distribution facility with its wholesalers.

(5) *Directives under the Department Stores Law*: The United States does not include the MITI directives issued between 1968 and 1971 under the Department Stores Law as measures that violate Article III or X or that nullify or impair benefits under Article XXIII:1(b). However, these directives form part of the factual context in which Japan carried out the restructuring of its distribution sector for photographic film and paper. The 1969 MITI-commissioned survey of transaction terms in the photographic film sector specifically described the growth of large stores, along with the competitive challenge of Kodak, as the two greatest threats to maintaining the oligopoly of Fuji and Konica. In the consultations, the United States mentioned that Japan saw the need to revise the Department Store Law and replace it with the more comprehensive Large Stores Law as part of the overall effort to insulate the distribution system from foreign control following capital liberalization.

(6) *International Contract Notification*: The United States alleges that the international contract notification provisions of the Antimonopoly Law have played an important role in protecting the exclusive distribution system fostered by Japanese Government policy. The international contract notification provisions require each contract between foreign manufacturer and a Japanese wholesaler to be reported to the JFTC. Once transaction terms are standardized, the JFTC more easily can find that transaction terms departing from the standard are unfair trade practices. In the consultations, the United States discussed Japan's policy of standardizing transaction terms and the rationale for this policy, including that standardized transaction terms would help to protect Japanese manufacturers against foreign competition. The United States referred to the following passage in the 1970 Guidelines: "In order to prevent foreign corporations with huge investment capacity from disrupting the trade order,

reasonable terms of trade must be clearly stated". The United States also quoted a passage⁹⁴ from an industry journal which explained the purpose of the guidelines that standardizing transaction terms would facilitate application of the Antimonopoly Law to non-standard practices. The United States also quoted from a report by the Foreign Investment Council, the companion government-industry committee to the Industrial Structure Council. This report⁹⁵ emphasized that the Antimonopoly Law could be used to help check the competitive advance of foreign suppliers. The United States underscores that Japan had clear notice of the US concern with standardized transaction terms as a means of blunting the competitive abilities of foreign firms, and its use of the Antimonopoly Law to support these policies. The United States maintains that Japan cannot be surprised that the first US submission described more precisely the mechanisms under the Antimonopoly Law that helped to force standardized terms upon foreign manufacturers.

(7) *JFTC Notification 17*: The United States asserts that JFTC Notification 17 was a tool employed by Japan to blunt the ability of foreign firms to make competitive offers to Japanese distributors. It essentially ruled out all manner of premiums from manufacturers to wholesalers, except those of token value that could be considered reasonable in light of normal business practice. Notification 17 reinforced the standardized transaction terms and the systemization policies which the United States discussed at length with Japan in the consultations and Japan thus cannot claim surprise that the first submission of the United States discusses Notification 17. In addition to being within the scope of the consultations on "distribution countermeasures", the United States submits that Notification 17 is also an interpretation or application of the Premiums Law which it considers as forming part of the "promotion countermeasures".

(8)-(9) *JFTC Notifications 5 and 34*: The United States maintains with respect to two other such interpretations or applications of the Premiums Law that it discussed the Premiums Law at length with Japan in the consultations. It stressed in particular the intent and effect of the Premiums Law in blunting the ability of foreign manufacturers to apply their competitive strengths in Japan. The United States quoted a passage from a report of the Foreign Investment Council⁹⁶ and emphasized that the limitations on competition under the Premiums Law worked to the disadvantage of companies who are not the dominant suppliers. In the US view, Notifications 5, 17 and 34 are cornerstone applications of the Premiums Law that impose substantial limits on the ability of foreign film manufacturers to offer meaningful premiums in connection with products sold in Japan. The substantial discussion of the Premiums Law during the consultations gave Japan more than adequate notice that its particular interpretations and applications of the law restricting competition were within the scope of this dispute.

3.24 **Japan** reiterates that the request for consultations in this case was overly broad and vague, and did not "identify" the measures for the purposes of Article 4.4 of the DSU, which requires the complaining party to include an "identification of the matter at issue". According to Japan, the

⁹⁴"In the case of the photographic sector, ... the reduction in tariffs and the capital liberalization, etc., makes the inroads Kodak is gaining a problem that it [the industry] faces. The Ministry of International Trade and Industry's guidelines for normalizing transaction conditions is what may be called an 'immunization'. ... [B]ecause of the fear of confusion of transaction order due to the development of liberalization, it [the Guidelines] embodies the idea of 'immunizing' the distribution system as a whole by rationalizing and clarifying the transaction condition of rebates and discounts The guidelines may be described as an attempt to equalize the conditions of competition. For instance, standard rebates were adopted so that the use of non-standard rebates by foreign capital may be checked by the application of the Antimonopoly Law." Draft Standard Contract for Film with Criteria for Standardization on Transaction Terms, Zenren Tsuho, August 1971, US Ex. 71-11.

⁹⁵"For the application of the Antimonopoly Law, while it may not be possible to specifically select foreign capital enterprises for differential treatment, foreign capital enterprises nevertheless have the strong capital and technical background of the parent company and are usually in an economically strong position. Consequently, it is believed that they often will become the object of the regulation of the Antimonopoly Law." US Ex. 67-5, pp. 76-78.

⁹⁶When foreign capital is brought into Japan, it is possible for a parent company to use vast amounts of capital to engage in dumping, offer premiums, and conduct large-scale advertising and public relations. Therefore ... it is necessary to fully study whether these actions qualify as unfair business practices as defined in Article 2 of the Antimonopoly Law and can be regulated pursuant to Article 19 of the Antimonopoly Law or under the Premiums Law.

consultations themselves in this case also did not identify these specific measures and the United States admitted as much during the first meeting with the panel. While the United States purports to demonstrate how "measures" were discussed in the preceding paragraph, in fact the discussion shows just the opposite. In Japan's view, the United States is forced to make rather strained arguments for each measure.

2. ***THE REQUEST FOR THE ESTABLISHMENT OF THE PANEL***

3.25 Article 6.2 of the DSU provides:

"The request for the establishment of a panel shall be made in writing. It shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly".

3.26 Japan submits that Article 6.2 of the DSU requires the complaining party to identify all alleged measures at issue in its request for the establishment of a panel, as well as the legal basis for its claims relating to those measures. Given that Article 4.4 of the DSU provides that a request for consultations includes "identification of the measure at issue", whereas Article 6.2 of the DSU requires that the panel request "identify the specific measures at issue", Japan argues that in the panel request greater specificity and detail is required than in the request for consultations. This requirement serves the important purposes of both providing notice to the parties complained against and third parties, and defining precisely what the panel should consider. Without a specific indication of the measures being challenged, the parties complained against cannot defend themselves adequately and third parties cannot judge whether they need to participate in the panel proceedings.

3.27 The **United States** explains that Article 6.2 of the DSU requires the complaining party to "identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly". The panel request then becomes the primary document defining the panel's terms of reference which "fulfil an important due process objective, i.e., giving the parties and third parties sufficient information concerning the claims at issue in the dispute in order to allow them an opportunity to respond to the complainant's case".⁹⁷ While the DSU requires greater specificity in the panel request than in the request for consultations, the United States argues that the panel request need not restate the consultations nor summarize the complaining party's first submission.

3.28 **Japan** further submits that Article 6.2 of the DSU reflects past panel practice, which consistently has interpreted the terms of reference narrowly. In *Canada - Administration of the Foreign Investment Review Act*, the panel declined to consider any measures related to "manufacture" of goods because of its terms of reference "which only refer to the purchase of goods in Canada and/or the export of goods from Canada."⁹⁸ The panel in *Norwegian Salmon* summarized the policy rationale for panels to confine themselves to the examination of matters identified in their terms of reference:

"[T]erms of reference served two purposes: definition of the scope of a panel proceeding, and provision of notice to the defending Party and other Parties that could be affected by the panel decision and the outcome of the dispute. The notice function of terms of reference was particularly important in providing the basis for each Party to determine how its interests might be effected and whether it would wish to exercise its right to participate in a dispute as an interested third party. The panel observed

⁹⁷Appellate Body Report on *Brazil - Measures Affecting Desiccated Coconut* ("*Brazil - Desiccated Coconut*"), adopted on 20 March 1997, WT/DS22/AB/R, p. 22.

⁹⁸Panel Report on *Canada - Administration of the Foreign Investment Review Act* ("*Canada - FIRA*"), adopted on 7 February 1984, BISD 30S/140, 158, para. 5.3.

that terms of reference often were standard terms of reference . . . in which the definition of the matter had been supplied by a written statement prepared entirely by the complaining party. In the light of these considerations, the Panel concluded that a matter, including each claim composing that matter, could not be examined by a panel under the Agreement unless that same matter was within the scope of, and had been identified in, the written statement or statements referred to or contained in its terms of reference ..."⁹⁹.

3.29 According to the **United States**, only two panel reports have considered the question of whether a "measure" should be considered within the panel's terms of reference.¹⁰⁰ A number of prior panel reports have considered the related, but different, question of whether "matters" or "claims" are within the panel's terms of reference.¹⁰¹ In the United States view, these prior decisions demonstrate that panels have excluded only those measures, claims, and matters that fall outside the parameters of the dispute as it was understood by the parties at the time the panel's terms of reference were established.

3.30 **Japan** submits that the outer limits of a panel's jurisdiction are defined by its terms of reference which in this case refer to the matter specified in the panel request. Panels should thus focus on the exact wording of the terms of reference to define precisely their mandate. Claims with respect to items raised by the United States in its first submission that had not been mentioned in its panel request should be dismissed at the outset as outside the scope of the Panel's terms of reference.

3.31 The **United States** contends that its request for the establishment of this Panel does not differ greatly from other WTO panel requests in the degree of detail provided. The panel request in the case concerning the *European Communities - Regime for the Importation, Sale and Distribution of Bananas* ("*EC - Bananas*") of April 1996 just described that the regime was established by an EC regulation, and subsequent legislation, regulations and administrative measures and that the regime and related measures appear to be inconsistent with the provisions of the WTO Agreements. The United States takes the position that in view of the nature of Japan's distribution measures in the consumer photographic film and paper market, it was necessary for the United States to describe those measures in similar terms.

3.32 **Japan** explains its position with regard to the differences between the issues for this case and those for the *EC - Bananas* case. Contrary to the US claims, in Japan's view, the panel request in this case differs greatly from the panel request for the *EC - Bananas* case. The panel request for the *EC - Bananas* case did apparently identify the basic EC regulation at issue which established the banana "regime" and referred to "the subsequent EC legislation, regulations and administrative measures that further define and implement the basic regulation." By contrast, in the present case, the cores of the

⁹⁹*United States - Norwegian Salmon*, ADP/87, 99, para. 336. Although this panel involved a dispute under the Antidumping Code, in Japan's view, the policy rationale is equally compelling in the present case.

¹⁰⁰In *Japan - Alcoholic Beverages* the panel ruled against the proposed inclusion of a new measure, the Taxation Special Measures Law, that was unrelated to the measure that had been discussed in consultations and named in the panel request, the Japan Liquor Tax Law. Panel Report on *Japan - Taxes on Alcoholic Beverages*, adopted on 1 November 1996, WT/DS8/R, para. 6.5. In *United States - Alcoholic Beverages*, the panel adopted an agreement of the parties as to the scope of the measures to be considered, but rejected Canada's request to include in the terms of reference "any new measure which may come into effect during the Panel's deliberations." BISD 39S/206, 227, para. 3.5.

¹⁰¹See, e.g., Panel Report on *United States - Denial of Most-Favoured-Nation Treatment as to Non-Rubber Footwear From Brazil*, adopted on 19 June 1992, BISD 39S/128, 148, para. 6.2 (rejecting two new "issues" under Article X and XXIII:1(b)); Panel Report on *United States - Restrictions on Imports of Sugar*, adopted on 7 November 1990, BISD 37S/228, 237, para. 3.19 (rejecting attempt to include new Article XIII "matter"); and *United States - Norwegian Salmon*, ADP/87, 99, para. 336 (rejecting attempt to include a new Article III "claim" where existing claims related to the Antidumping Agreement). Cf. Panel Report on *United States - Section 377 of the Tariff Act of 1930*, adopted on BISD 36S/345, 383, para. 5.5 (accepting two new EEC arguments relating to "legal procedures").

measures in question themselves are presented with such unclear expressions as "liberalization countermeasures," a phrase created by the United States, and many of the alleged measures are not the kind of measures which "further define and implement the basic regulation," but are presented with vague and undefined expressions like "but not limited to" and "other related measures including guidelines."

3.33 Japan further argues that although the panel on the *EC - Bananas* case states that "the DSU must be interpreted so as to promote the prompt settlement of disputes, without adopting a reading of DSU provisions that would prolong disputes unnecessarily," undue emphasis on the promptness of the settlement without taking due account of the defending party's burden may invite abuse of the dispute settlement system and could cause serious damage to the proper operation of the system. Japan submits that the DSU must be interpreted so as to serve the purpose of the fair settlement of disputes.

3.34 The **United States** urges the Panel to include the measures subject to Japan's procedural objections within its terms of reference

- (1) because Japan was on adequate notice of the measures implicated in the US request;
- (2) because Japan has not complained that any of the measures are not "related" to measures that were discussed at the consultation and named in the panel request; and
- (3) because of the nature of the measures themselves.

(a) Adequate notice

3.35 From the standpoint of the object and purpose of Article 6.2, the **United States** argues that its panel request was more than sufficient in view of the Appellate Body's finding in its report in the *Brazil - Desiccated Coconut* dispute that "terms of reference fulfil an important due process objective - they give the parties and third parties sufficient information concerning the claims at issue in the dispute in order to allow them an opportunity to respond to the complainant's case".¹⁰²

3.36 In the current dispute, the United States claims that Japan was not denied "an opportunity to respond to the [US] case". As its first submission demonstrates, Japan did not lack an understanding of the problem the United States was complaining about. Japan had six weeks to respond to the first US submission which is double the maximum amount of time in the DSU's proposed timetable for panel work. If there were any prejudice caused to Japan by the inclusion in first US submission of the nine measures which are subject to Japan's procedural objections, the United States argues that prejudice has been cured by the extraordinarily long period of time that Japan had to prepare its first submission.

3.37 **Japan** responds that even if it had more time to prepare its first submission that would not excuse the violation of Article 6.2 of the DSU. Moreover, disclosure after the panel request does nothing to remedy the harm suffered by third parties who might have made different decisions about whether or not to participate based on the specific items raised in the panel request. Japan further submits the following four points. First, a written submission does not substitute for the notice function required by Article 6.2 of the DSU. For another, the lack of specificity in the panel request requires extensive work on the defending party for the preparation of its defense, which could be avoided if the panel request were sufficiently specific. Making the defending party engage in what may eventually turn out to be unnecessary work, and in view of the limited amount of resources and time available, constraining their ability to defend adequately is prejudicial and unfair. Thirdly, the first US submission included such measures as international contract notification, SMEA financing, and JDB loan, the inclusion of which Japan was not able to foresee even after extensive preparation. Finally, the US

¹⁰²*Brazil - Desiccated Coconut*, WT/DS22/AB/R, p. 22. See also *United States - Norwegian Salmon*, ADP/87, 99, para. 336.

first submission itself still did not clarify which measures are complained against. Even the list of the "measures" submitted by the United States in response to a question by the Panel at the first substantive meeting included vague expressions, such as "related regulations and administrative measures, including related local measures."

3.38 The **United States** contends that all the measures in question are elements of Japan's liberalization countermeasures plan; six are "distribution measures, such as, but not limited to" the measures identified in the body and Attachment A of the US panel request; and three are notifications made by the JFTC pursuant to the Premiums Law or the Antimonopoly Law identified in the body of the US panel request. According to the United States, its panel request stated explicitly and clearly the problem that the United States was asking the panel to address and gave Japan and third parties sufficient information concerning the claims at issue in the dispute for them to respond fully to the United States.

(b) Related measures

3.39 According to the United States, in the current dispute, the measures that Japan would have the Panel exclude from consideration are an integral part of the corpus of the distribution and premiums countermeasures, they were discussed in detail during the consultations and thus do not fall outside the parameters of the dispute as the parties understood it.

3.40 **Japan** requests the Panel to exclude the vague and overly inclusive expressions used by the United States in the panel request as inconsistent with Article 6.2 of the DSU. Only "measures" specifically mentioned in the panel request should be deemed to be brought properly before the Panel. At the DSB meeting of 16 October 1996, when the Panel was established, Japan expressed its serious concerns about the procedural problems of the US request for the establishment of the panel in light of the DSU, and reserved its rights to request the Panel to make a ruling on the matter.¹⁰³

3.41 In particular, in Japan's view, "liberalization countermeasures", to which the United States refers in its panel request, are not a set of concrete measures, but rather a generic term, and are too general and ambiguous to be regarded as "specific measures" in the sense of Article 6.2. Attachment A, in which the United States listed what it believes to be "distribution measures", contains a measure which Japan is unable to identify, namely the "Administrative Guidance to Promote Rationalization of Distribution System, 1966".

3.42 The **United States** submits that it used the term "distribution measures" in its panel request to refer to the series of measures used to implement Japan's policy of restructuring the distribution system for photographic materials into exclusionary distribution channels. The United States included Attachment A in its panel request to indicate the types of measures that were included in the term "distribution measures", even though, in the US view, Japan would have fully understood the meaning of that term based on the consultations between the parties.

3.43 **Japan** claims that there are other references in the panel request which imply that the United States has not yet identified specific measures at issue, e.g., expressions such as, "but not limited to", "other related measures, including guidelines", which appear in Attachment A, as well as "related measures" which is found at the end of the first paragraph of the panel request.

3.44 The **United States** responds that the phrases "measures, such as, but not limited to" in line 4 of the first paragraph and "other related measures, including guidelines" at the end of Attachment A indicate that Attachment A is an illustrative, not exhaustive, list of the distribution measures that Japan used to close the primary Japanese distribution channels to imported film and paper. The phrase "and

¹⁰³WT/DSB/M/24.

related measures" at the end of the first paragraph refers to amendments, regulations, administrative guidance, notifications, and surveys, that Japan implemented with respect to

- (a) the Large Stores Law;
- (b) Special Measures for the Adjustment of Retail Business;
- (c) the Premiums Law;
- (d) measures regarding dispatched employees pursuant to the Antimonopoly Law;
- (e) the Law Concerning Enterprise Reform for Specified Industries;
- (f) the Ministry of International Trade and Industry Establishment Law.

3.45 **Japan** points out that the United States continues to use vague expressions in its response to the Panel question for clarification of its claims. The response included expressions such as "including related actions to implement recommendations in the Guidelines"; "including actions to implement recommendations"; and "related regulations and administrative measures, including related local measures". Since these expressions hardly indicate "specific measures", Japan criticizes that the United States continues not to clarify the scope of its claims and emphasizes that a complaining party should not be allowed continually to raise additional items in a panel proceeding.

3.46 Given that, according to the **United States**, Japan does not dispute that the measures with respect to which it raises procedural objections are "related to" the measures that the United States specifically named in its panel request, the Panel should consider these related measures to be within its terms of reference.

3.47 **Japan** contests that the nine items identified against which it has raised procedural objections as well as rules on loss leader advertising, are not "related" to those that are properly before the Panel. With respect to the US argument that Japan had not early enough objected to the "relatedness", Japan responds that, since the United States first made this argument in the first substantive meeting of the Panel, Japan could not respond until that time. Japan further argues that the United States should bear the burden of establishing the "relatedness" of these measures not specifically mentioned in the panel request. Japan should not bear the burden of proving the converse. While the United States has made general claims about these items, Japan takes the position that the United States has not identified the measures properly before the Panel to which these measures are "related".

3.48 Specially, Japan contends that several of these measures which are subject to its procedural objections bear no meaningful relationship to the US claims regarding Japanese policies on distribution, large stores, or sales promotions. In particular, Japan submits that:

(2-3) *SMEA and JDB Financing*: Japan recalls that the US defense is that the mere phrase "positive support" in the 1971 Basic Plan should have been sufficient to place Japan on notice about the SMEA and JDB financing programs. With respect to the US allegation that during the consultations it pointed out that the 1971 Basic Plan looked to "financial incentives", Japan notes that according to its record and recollection, this point was never raised in the consultations. Japan declares that the United States is looking for isolated phrases in documents to excuse its failure to specify what measures were to be at issue in this dispute. In Japan's view, the phrase "positive support" is too vague to constitute any meaningful notice to Japan or to establish any relationship between the measures identified in the panel request and the measures ultimately attacked by the United States.

(4-5) *"Measures" by the Photosensitive Committee and Directives under the Department Stores Law*: Japan notes that the United States itself dropped these items from those it requests the Panel to consider.

(6) *International Contract Notification*: Japan notes that in the US panel request the only item mentioned with respect to the Antimonopoly Law was "measures regarding dispatched employees", an issue unrelated to the international contract notification requirement under the Law.

3.49 Japan concludes that the Panel should exclude vague and overly inclusive expressions from the scope of the terms of reference and only those "measures" specifically mentioned in the panel request for the establishment of the Panel should be deemed properly before the panel. Otherwise the scope of the panel request and thus the terms of reference themselves would be rendered meaningless. If the United States needed more time to translate or evaluate Japanese language materials, it could simply have waited to make its panel request. When the complaining party reaches the stage of a panel proceeding, it must be ready to identify specific measures as the basis of its claim. Japan insists that US efforts to include vague "catch-all" phrases are contrary to the basic principles of the WTO dispute settlement process.

(c) **Nature of the measures**

3.50 The **United States** further submits that Japan was aware that the United States is complaining about a collection of measures, not a single measure, that resulted in the creation of an exclusionary distribution system for consumer photographic materials. Had Japan implemented its distribution policies through transparent laws and regulations, the United States would not have needed to go to such great lengths to describe the distribution measures in its panel request. Therefore, United States asserts that the means selected by it to describe these measures are necessitated by the nature of the measures themselves. It had taken the United States years to fully understand Japan's labyrinth of liberalization countermeasures and it continues to learn every day, including the names and applications of other related measures that constitute individual bricks in Japan's protectionist wall. In the US view, Japan has used an extraordinary array of measures which have been difficult to identify and fitting the pieces of this puzzle together has been an extremely difficult task. To dismiss the measures in question as being beyond the Panel's terms of reference would reward Japan for its nontransparent approach to protectionism and would give responding parties an incentive for withholding information in consultations, and would prevent the United States from obtaining complete relief from a problem that is well understood by Japan. The United States submits that such a dismissal would not be within the letter or the spirit of the DSU.

3.51 **Japan** rebuts that the US allegations concerning the nature of the measures are undermined by the breadth and detail of the US submission given that in the thousands of pages in the appendix to its submission, the United States has provided translated copies of the reports and other items it considers relevant to Japan's various policies. The policies have all been published and are publicly available, and thus these supposedly opaque policies are actually easily accessible to the public. Japan points out that the United States had no problem identifying everything with perfect specificity just several weeks after drafting its panel request. The fact that the United States did not review these materials earlier in no way means the United States could not have done so. Japan asserts that the US complaint essentially seems to be "we should not have to wait to request a panel until we know what we are complaining about". Japan emphasizes that Article 6.2 of the DSU requires the United States to wait until it can precisely identify the specific measures involved in a dispute.

IV. SUMMARY OF ARGUMENTS

4.1 The claims raised by the United States concern three broad categories of measures: (1) distribution measures, which allegedly encouraged and facilitated the creation of market structures for film and paper in which imports are excluded from traditional distribution channels; (2) the Large Stores Law, which allegedly restricts the growth of an alternative distribution channel for film; and (3) restrictions on premiums and misleading representations under the Premiums Law, which allegedly disadvantage imports by restricting sales promotions.

A. DISTRIBUTION "COUNTERMEASURES"

4.2 The **United States** argues essentially that at the beginning of the Kennedy Round in 1963, foreign and domestic manufacturers distributed photographic film and paper through Japan's primary wholesalers who, in turn, sold to other wholesalers or retailers. Photographic material manufacturers competed against one another to market their products to the same wholesalers. Foreign as well as Japanese manufacturers did business with many of Japan's distributors. By the mid-1970's, however, when many formal market barriers had fallen, the Japanese Government had fundamentally altered relationships between manufacturers and wholesalers. By then, all of the leading wholesalers in Japan exclusively handled Japanese products. The United States claims that so far no foreign firm has succeeded in penetrating these closed distribution channels.

4.3 According to the United States, when the liberalization of international trading conditions became imminent, MITI and Japanese manufacturing interests recognized that foreign firms in many instances were not only positioned to offer competitive products, but also to deploy superior resources and managerial expertise in distribution and marketing. MITI foresaw that these foreign advantages could create serious competition for Japanese manufacturers and their products and that foreign enterprises would be able to displace domestic manufacturers at the wholesale and retail levels. MITI officials and Japanese manufacturers therefore jointly devised a plan to streamline Japan's distribution system while at the same time bringing it under the control of domestic producers. Under this policy, which was referred to as the "systemization of distribution", MITI sought to strengthen vertical distribution channels from manufacturer to wholesaler to retailer in order to establish distribution chains of wholesalers and retailers that would exclusively handle the products of a particular domestic manufacturer.

4.4 The United States alleges that MITI targeted three ways to tie distributors more closely to domestic manufacturers:

First, MITI promoted the use of transaction terms that would result in a distributor selling the products of just one domestic manufacturer: volume discounts, rebates and standardized and shortened payment terms. Discounts and rebates encouraged wholesalers to purchase greater volume from fewer suppliers. The standardized and shortened payment terms limited the opportunities for wholesalers to seek better credit rates from other suppliers. This left wholesalers more dependent on and vulnerable to the credit terms offered by the manufacturer with whom they primarily did business.

Second, MITI urged the photographic materials industry to rely upon shared facilities and operations, such as joint warehouses and distribution routes. The government offered subsidies, expertise, and other benefits to induce businesses to enter into more cooperative arrangements.

Third, MITI determined that common information and computer links would forge closer relationships among a particular Japanese manufacturer and its downline wholesalers and retailers. MITI therefore guided manufacturers and wholesalers to use standardized data bases, commercial orders and financial information.

4.5 The United States further claims that at the same time MITI sought to tighten the bonds among horizontal elements of the distribution system. MITI attempted to join retailers into "voluntary chains" that would do business with affiliated Japanese manufacturers. The principal result would be the consolidation of previously independent photo finishing laboratories within newly-formed groups of Japanese retailers or wholesalers, or in a consortium doing business with a single Japanese manufacturer.

4.6 **Japan** responds that the aim of MITI's distribution policies was not to block imports but to modernize the Japanese distribution industry and help it to meet the foreign competitive challenge that would be unleashed by liberalization. Nothing in MITI's distribution policies or any other so-called "liberalization countermeasures" did anything to encourage or facilitate the creation of an exclusionary market structure that discriminates against imported film or paper. Since the MITI policies in question actually say nothing about encouraging single-brand distribution of film, the United States struggles to establish some connection between MITI's policies and the market structure that is the main target of its complaints. Japan asserts that when confronted with the actual facts of this market, however, the US arguments about "distribution countermeasures" collapse.

4.7 Japan further responds that MITI's concern with modernizing the Japanese distribution sector has existed continuously for over 30 years, including the periods before and after capital liberalization. According to Japan, MITI had diverse rationales for encouraging distribution modernization. Originally, MITI sought to improve the relatively low productivity of the distribution sector, thereby alleviating a growing labour shortage and the continuing increase in consumer prices in the late 1960s. To the extent that MITI's distribution modernization policies were a response to capital liberalization, MITI's concern was to improve the efficiency and competitiveness of a relatively backward distribution sector. The objective was to compete more effectively with new foreign entrants. MITI was not trying to prevent imports from enjoying the allegedly unique advantages of traditional distribution channels. To the contrary, MITI viewed traditional distribution channels as competitively disadvantaged and sought to remedy their defects.

4.8 Japan explains more specifically that MITI's distribution policies in the 1960s and '70s pursued modernization through both rationalization and systemization policies. As to the rationalization policies, the objective was to eliminate traditional outmoded business practices considered to be economically irrational. In the film sector, MITI's issued the 1970 Guidelines for Rationalization of Transaction Terms which explicitly discouraged the use of rebates and did not call for shorter payment terms. Thus, in Japan's view, they were unrelated and inimical to the establishment of single-brand distribution.

4.9 Moreover, Japan argues that the US theory has intractable timing problems. Three of Fuji's four major primary wholesalers were already single-brand distributors by 1968, two years before the guidelines were issued. While Fuji's fourth primary wholesaler did not become a single-brand distributor until after the issuance of the Guidelines, it only made this private business decision after Kodak explicitly refused to deal with the primary wholesalers directly. As to the other domestic manufacturer, Konica, all of its primary wholesalers had been single-brand distributors by 1955. There was thus no causal connection between the 1970 Guidelines and the development of single-brand wholesale distribution in the film sector.

4.10 Japan further explains that the second objective of MITI's distribution modernization policies was systemization.¹⁰⁴ These policies encouraged the adoption of standardized forms and procedures, and the increased use of computer technology. In the film sector, a study group in a MITI-commissioned public corporation issued a manual along these lines in 1975. According to Japan, systemization of distribution was believed to facilitate, not exclude or discourage, entrance of foreign companies, because

¹⁰⁴As discussed below, Japan argues that MITI distinguished between rationalization and systemization policies. The United States uses the single term "systemization" to cover both concepts.

standardization would alleviate the burden of having to adjust to hundreds or thousands of individualized ways of doing business.

4.11 Japan points out that the US allegations ignore the timing of the alleged measures and what actually happened in the market. According to Japan, single-brand distribution occurred as an industry trend before the alleged measures were implemented. Also Fuji did not establish its first on-line connection with a primary wholesaler until 1989, 14 years after the alleged government action was taken. There was simply no causal connection between MITI's systemization policies, and the decisions by primary wholesalers about which film brands to carry.

4.12 Japan further contends that there is nothing at all unusual about the Japanese market structures for film and paper. Single-brand wholesale distribution of film is a common business practice which prevails in every major market in the world. Likewise, affiliations between photosensitive materials manufacturers and photofinishing laboratories prevail worldwide. The consistent prevalence of these market structures around the world is due to market factors, not government measures.

4.13 Japan notes MITI's efforts to promote distribution organization continue to this day. To this end, in 1990 MITI issued distribution guidelines that once again addressed the same kinds of "irrational" distribution practices that had been targeted by the 1970 Guidelines, e.g., unclear rebates, liberal returns, and dispatched employees to customers. Now, however, *encouraging* imports was one of the guiding purposes for targeting these practices. For its part, the United States has strongly endorsed the 1990 Guidelines. As recently as November 1996, during the pendency of this proceeding, the United States specifically urged MITI to "maintain and report an adherence by the Japanese business community" to these Guidelines. In Japan's view, the internal inconsistency of the US position is remarkable because the United States is simultaneously urging Japanese business to follow the current administrative guidance on rationalizing distribution practices *and* arguing before this Panel that similar guidance 20 years earlier was part of an anti-import conspiracy.

B. LARGE STORES LAW

4.14 The **United States** argues that large retail stores remain one potentially significant alternative distribution channel despite the Japanese Government's reorganization of wholesale operations in the photographic materials sector. In the late 1960's, the number of supermarkets and other "self-service stores" was growing rapidly and, in the US view, such large retailers offered foreign manufacturers, foreclosed from the primary distribution network, a partial alternative to wholesalers. The United States claims that large stores have carried imported products, including film, more frequently than small stores and have been less susceptible to pressure by domestic manufacturers. If such stores were permitted to proliferate across Japan, wholesalers would become less significant and foreign manufacturers could circumvent the bottle-necked distribution system. In response to this threat, the United States submits, in 1967 and 1968 Japan began to impose controls on the expansion of large stores and finally enacted the Large Stores Law in 1973. This law imposed a burdensome process on the opening and expansion of large retail stores.

4.15 **Japan** explains that the Large Stores Law reflects longstanding Japanese policy--dating back to the enactment of the Department Store Law in 1956--of regulating large stores to preserve a diversity of small, medium and large retailing competitors, a policy found in other countries as well. Japan contends that the law does not concern products generally, or film in particular. The law does not regulate which products large retailers can carry, nor does it take into account which products a retailer sells when determining whether and what adjustments are necessary. Accordingly, in Japan's view, the Large Scale Retail Store Law is incapable of adversely modifying competitive conditions for any imported products, including film. As to the US argument that large stores are more likely to carry imports, in Japan's view, retailers, whether large or small, choose the brands they carry to maximize profit; there is no reason to believe that the size of stores in any way changes the profitability of a

particular product. Thus, there is no difference between them in choosing the products they carry. Further, there is in fact no correlation between a store's size and its likelihood of carrying foreign film brands, although a competitive relationship cannot be deduced from market survey results. Japan also notes that the law has been significantly liberalized in recent years and is more favourable to imports now than at the time of any of the relevant tariff concessions.

C. PROMOTION "COUNTERMEASURES"

4.16 The **United States** argues that Japan has reinforced the distribution countermeasures not only through legal restrictions on retail stores but also through a system of measures limiting how photographic material manufacturers, wholesalers and retailers may promote their products in order to expand their sales of photographic film and paper in the Japanese market by means of economic inducements and aggressive advertising. The United States claims that "promotion countermeasures" have disadvantaged foreign manufacturers of film and paper by constraining their ability to use certain discounts, gifts, coupons, and other inducements, or to rely upon innovative advertising campaigns, particularly where price or price comparisons are discussed. The United States argues that Japan has implemented these promotion countermeasures through the Premiums Law and certain regulations issued by the JFTC under the Antimonopoly Law. Although these measures also apply to domestic film and paper producers, the United States contends that Japan has imposed them with the intention of striking against two aspects of international competition by foreign imports following trade liberalization, i.e., (i) the strong capitalization and cost competitiveness of foreign manufacturers and (ii) their ability to convert these resources into potent marketing strategies and aggressive promotional competition.

4.17 **Japan** responds that the Premiums Law imposes restrictions only on excessive premiums and regulates only misleading representations. In the interest of consumer protection, the Premiums Law is designed to effectively deal with unfair trade practices and encourage manufacturers to compete principally on the basis of price and quality, not unfair inducements or deceptive and misleading representations. Japan emphasizes that the law makes no distinctions between imported or domestic products. Japan further argues that the Premiums Law does not hinder vigorous price and promotional competition. Low price offers are not only permitted, but are, in Japan's view, facilitated by the law and a broad range of promotional practices are consistent with the law. All companies, both domestic and foreign, have been and continue to be free to spend as much money as they want on advertising. Companies are free to use any expressions they wish, so long as they do not deceive or mislead consumers. Japan also submits that no businesses have ever been restricted from offering promotional gifts or prizes by lotteries and competition, so long as they are in line with the standards set in accordance with the law to protect consumers. In Japan's view, these standards are no more rigid than those set by similar laws in many other countries. Japan also contends that in some respects, the standards are actually less rigid than those of the United States because certain types of lotteries and prize competitions prohibited in the United States have been allowed in Japan.

4.18 The **United States** points out that enforcement actions under the Premiums Law may be taken by the JFTC and the 47 prefectural governments. In addition, the JFTC has given its official sanction to so-called "fair competition codes" promulgated by private sector "fair trade councils". The United States also argues that the "fair trade councils" have authority to discipline members who violate the codes, often employing methods of coercion and monetary penalties. The United States further claims that the standards established by the councils in their codes typically are adopted by the JFTC, which then applies the same rules to "outsiders". According to the United States, the Premiums Law expressly exempts the cartel-like practices of the councils from antitrust enforcement.

4.19 **Japan** responds that private "fair competition codes", and the "fair trade councils" are not relevant to this case because no "code" or "council" covers photographic film and paper. The Retailers Council is merely responsible for the observance of the code against misleading representations and has no authority to enforce the Premiums Law nor may it restrict low price offers in any way.

D. THE COMBINED EFFECT OF THE THREE SETS OF MEASURES

4.20 *Distribution countermeasures:* The **United States** claims that the distribution countermeasures operate as a set, i.e., the distribution countermeasures acting in combination, on the one hand, violate Article III:4 and, on the other, nullify or impair benefits under the GATT within the meaning of Article XXIII:1(b).

4.21 *Distribution countermeasures in combination with the Large Stores Law:* The United States further claims that the Large Stores Law and related measures and the distribution countermeasures *in combination* nullify or impair benefits under the General Agreement within the meaning of Article XXIII:1(b).

4.22 *Restrictions on large stores:* The United States also claims that the Large Stores Law and related measures *by themselves*, in the context of a closed distribution system, nullify or impair benefits under the General Agreement within the meaning of Article XXIII:1(b), in addition to the position stated above regarding the Large Stores Law acting in combination with the distribution countermeasures.

4.23 *Promotion countermeasures:* A further US claim is that the promotion countermeasures as a set *by themselves* have nullified or impaired benefits under Article XXIII:1(b), given that in the current market structure in Japan foreign manufacturers effectively had no access to the primary wholesaler channels.

4.24 *Promotion measures, distribution measures and restrictions on large stores:* The United States further claims that the promotion countermeasures as a set have operated *in combination* with Japanese Government efforts to restructure the distribution system through the distribution countermeasures and restrictions on large stores to nullify or impair benefits under the GATT within the meaning of Article XXIII:1(b).

4.25 **Japan** contends that the US claims against the three categories of measures acting in combination with each other are factually and logically flawed. According to Japan, the United States did not submit credible evidence that the measures were intended to and in fact acted in combination. In Japan's view, the distribution policies, the Large Stores Law and the promotion measures pursue very different policy objectives, and were not intended to work together.

4.26 *In summary*, the **United States** alleges:

- a. The distribution countermeasures, Large Stores Law and related measures, and promotion countermeasures in combination nullify or impair benefits within the meaning of Article XXIII:1(b).
- b. The distribution countermeasures, as a set, also
 - i. violate Article III:4 and
 - ii. nullify or impair benefits within the meaning of Article XXIII:1(b).
- c. The Large Stores Law and related measures also nullify or impair benefits within the meaning of Article XXIII:1(b), in the context of the restrictive distribution structure in Japan.
- d. The promotions countermeasures, as a set, nullify or impair benefits within the meaning of Article XXIII:1(b), in the context of the restrictive distribution structure in Japan.
- e. The specific failures to publish the fair trade councils' and JFTC enforcement actions as well as guidance by MITI, prefectural and local authorities under the Large Stores Law

or related local regulations, that establish or modify criteria applicable in future cases, each constitute a violation of Article X:1.

4.27 **Japan** rejects all these US claims with respect to the various individual allegations since, in its view, none of the alleged measures individually adversely affect imported products or alter the conditions of competition facing imported products. Japan emphasizes that even when the distribution policies, large store laws and the promotion measures are considered as "sets of measures" with combined effects, they do not in any way disadvantage imports because combining nothing with nothing still produces nothing.

4.28 For a detailed discussion of the parties' arguments with respect to the allegations concerning the three sets of measures acting in combination, see Section VI.F. below.

V. FACTUAL ARGUMENTS OF THE PARTIES

A. DISTRIBUTION "COUNTERMEASURES"

1. OVERVIEW

5.1 The **United States** argues that at the beginning of the Kennedy Round in 1963, foreign and domestic manufacturers distributed photographic film and paper through Japan's primary wholesalers who, in turn, sold to other wholesalers or retailers. Photographic material manufacturers competed against one another to market their products to the same wholesalers. Like Japanese manufacturers, foreign manufacturers did business with many of Japan's distributors. By the mid-1970's, however, when many formal market barriers had fallen, the Japanese Government had fundamentally altered relationships between manufacturers and wholesalers. By then, all of the leading wholesalers in Japan exclusively handled Japanese products. The US conclusion is that to this day, no foreign firm has succeeded in penetrating these closed distribution channels.

5.2 The United States claims that, starting with the Kennedy Round tariff concessions, Japan imposed laws, regulations and administrative actions to strengthen the dominant position of domestic consumer photographic materials manufactures and curtail opportunities for imports that would otherwise be available. While many of these measures do not bear the typical characteristics of protection, i.e. the measures are not facially discriminatory against imports, when they are seen in their totality they reflect a unique system of distribution and marketing management that has pervasively disadvantaged imported photographic materials.

5.3 In particular, the United States argues that as trade and investment liberalization approached in the late 1960's, the Japanese Government and industry began to work together to create the distribution structure that remains in place today. The US argument is that this situation in the Japanese photographic materials market is not as a result of market forces, but by deliberate manipulation by the Japanese government. This was done to offset the possible effects of liberalization and the resultant competition from foreign firms with better expertise in distribution and marketing. As a result, MITI and Japanese manufacturers jointly began streamlining Japan's distribution system and at the same time bringing it under the control of domestic producers - a policy which became known as "systemization of distribution". Japan accomplished this in three ways -

- (i) MITI promoted the use of transaction terms that would result in a distributor selling products of just one domestic manufacturer - volume discounts, rebates, and standardized shortened payment terms. Discounts and rebates encouraged wholesalers to purchase greater volume from fewer suppliers. Standardized and shortened payment terms limited the opportunity for wholesalers to seek better credit rates from other suppliers.
- (ii) MITI urged the photographic materials industry to rely upon shared facilities, and the government offered subsidies, expertise, and other benefits to induce businesses to enter into more cooperative arrangements.
- (iii) MITI determined that common information and computer links would forge closer relationships among a particular Japanese manufacturer and its own downline wholesalers and retailers.

5.4 **Japan** responds that the aim of MITI's distribution policies was not to block imports but to modernize the Japanese distribution industry and help it to meet the foreign competitive challenge that would be unleashed by liberalization. Nothing in MITI's distribution policies or any other so-called "liberalization countermeasures" did anything to encourage or facilitate the creation of an exclusionary

market structure that discriminates against imported film or paper. Since the MITI policies in question actually say nothing about encouraging single-brand distribution of film, the United States struggles to establish some connection between MITI's policies and the market structure that is the main target of its complaints. Japan asserts that when confronted with the actual facts of this market, however, the US arguments about "distribution countermeasures" collapse.

5.5 Japan notes that MITI's concern with modernizing the Japanese distribution sector has existed continuously for over 30 years, including the periods before and after capital liberalization. Throughout this period, MITI has had diverse rationales for encouraging distribution modernization. Originally, MITI sought to improve the relatively low productivity of the distribution sector, thereby alleviating a growing labour shortage and the continuing increase in consumer prices. These policy goals had nothing to do with alleged efforts to block imports.

5.6 Japan argues that concerns with capital liberalization were simply added to the broader set of preexisting policy concerns about the need for modernization in the late 1960's. To the extent that MITI's distribution modernization policies were a response to capital liberalization, MITI's concern was to improve the efficiency and competitiveness of a relatively backward distribution sector, not to hinder imports' access to this sector. The objective was to compete more effectively with new foreign entrants. MITI was not trying to prevent imports from enjoying the allegedly unique advantages of traditional distribution channels. To the contrary, MITI viewed traditional distribution channels as competitively disadvantaged and sought to remedy their defects. Japan further argues that MITI's distribution policies in the 1960's and 1970's pursued modernization through both rationalization and systemization policies. As to the rationalization policies, the objective was to eliminate traditional outmoded business practices considered to be economically irrational.

5.7 The **United States** provides three rebuttals to Japan's argument that the purpose of the distribution countermeasures was not to block imports but rather to modernize the distribution sector. First, the MITI measures at issue clearly and repeatedly distinguish between the goal of efficiency and the goal of responding to liberalization. Indeed, the Seventh Interim Report emphasized that to the extent fostering efficiency became inconsistent with protection against foreign competition, the latter goal should win out: "the Japanese Government should instead emphasize preventing the immense impact that would be felt if foreign capital took the lead in systemizing Japan's distribution activities, and quickly develop a system sufficiently capable of resisting the rational systems introduced by foreign capital."¹⁰⁵ Second, these same MITI documents repeatedly note the threat that foreign access to *distribution* would have on Japanese *producers*. The policy concern was not, therefore, purely the effect of foreign competition on the distributors themselves but included concerns over the effect on the domestic producers' market share.¹⁰⁶ Third, the United States notes that Japan itself acknowledges that Japan was concerned about Kodak's competitive strength and therefore implemented policies to ensure that Japan's domestic manufacturers were not exposed to full competition from Kodak.

2. ***DEVELOPMENT OF THE JAPANESE FILM MARKET***

5.8 According to the United States, in the early 1960's, Japanese film manufacturers operated under protection from foreign competition. Japan imposed quantitative restrictions and 40 percent tariffs on film imports. The Japanese Government also tightly restricted investment through the 1949 Foreign Exchange and Foreign Trade Control Law, which allowed the Ministry of Finance to control virtually all foreign exchange transactions, and the 1950 Foreign Investment Law, which gave the Japanese Government authority to regulate all equity investment and technology transfer. As a result of these

¹⁰⁵Seventh Interim Report, p. 7, US Ex. 69-4.

¹⁰⁶See the 1967 Cabinet Decision, p. 6 (para 2.9 above; US Ex. 67-6), the Sixth Interim Report (para. 2.14 above; US Ex. 68-8), the Seventh Interim Report (para. 2.15 above; US Ex. 69-4), the Basic Plan, p. 10 (para. 2.20-2.22 above; US Ex. 71-10), the 1975 Manual, pp. 121-122 (para. 2.23-2.25 above; US Ex. 75-5).

laws, the Government of Japan substantially limited foreign investment in manufacturing, distribution, and retail facilities in Japan.

5.9 The United States argues that, using these investment laws, the Government of Japan pressured Kodak into abandoning its corporate charter in Japan in 1957, forcing Kodak to abandon its own distribution facilities. Afterwards, Kodak shifted to relying on 15 Japanese wholesalers to import and distribute its products in Japan. In 1960, to ease implementation of its film import quantitative restrictions, the Japanese Government required Kodak to select one Japanese firm to serve as its sole import agent. Kodak selected Nagase Industries, an import-export trading company that specialized in chemical products, with which Kodak had ties dating back to 1923. As a result of the Japanese requirement, all wholesalers distributing Kodak products had to purchase them from Nagase, and Kodak had to rely on Nagase to establish and maintain its commercial network in Japan.

5.10 The United States further argues that, after joining the Organization of Economic Cooperation and Development (OECD) in 1964, Japan slowly liberalized its investment restrictions. Foreign photographic materials manufacturers were prohibited from forming a limited or equal partnership (50-50) joint venture until 1971. However, a like-industry clause adopted in 1971 limited such investments except in ventures between direct competitors (e.g. Kodak or Agfa investment in Fuji or Konica). Photographic materials manufacturers were not permitted to own 100 percent of a new enterprise until 1976. Not until 1979 were foreign photographic materials manufacturers finally permitted to acquire a controlling interest in existing Japanese enterprises. However, foreign firms in the photographic materials sector continued to be subject to MITI and Ministry of Finance notification requirements for investments in existing Japanese enterprises until July 1, 1985. In short, although investment restrictions in the photographic materials sector have been lifted, foreign film producers continue to suffer the after-effects of their hitherto existence. Delays in capital liberalization in the film sector prevented foreign firms from making investments until it was too late.

5.11 **Japan** counters by arguing that it is not correct that capital restrictions prevented all investment in securing better distribution channels for imported products. According to Japan, during the period before capital liberalization, if Kodak had wanted to use investments to establish and build relationships with any single-brand primary wholesalers it could have done so. Moreover, Kodak's exclusive importer Nagase could and did invest in distribution by buying two primary wholesalers; it could legally have made equity investments in Fujifilm's primary wholesalers if it had wanted to. The fact that Kodak did not exercise all its legal options -- indeed, Kodak itself exercised virtually none of its legal options -- demonstrates that the presence of capital restrictions was not interfering with any Kodak business plans at the time. Secondly, for Japan the US argument makes no sense in light of the actual record of foreign investments in the Japanese market after capital investments were lifted. According to Japan, Kodak instead of investing did nothing but use the fear of direct investment to create pressure to accelerate cuts in tariff rates. In Japan's view, Kodak opted to treat Japan as an export market rather than as a target for investment.

5.12 Further, Japan argues that the US argument is at odds with assessment by industry experts, including Kodak officials, to move faster in establishing its own distribution channels. Even Kodak executives recognized their error. In a 1988 interview, the then President of Kodak Japan, Mr. Albert Sieg, stated:

"The glaring mistake was waiting so long to take aggressive action in this market. We should have been here with this approach ten years ago. Clearly, the momentum of our local competitors got a strong forward thrust, and our task will be much, much more difficult."¹⁰⁷

¹⁰⁷Taking on Japan (Look Japan Ltd., ed.) (1988), p. 38, Japan Ex. B-45.

Japan concludes, therefore, that the timing of capital liberalization for photographic materials had absolutely no impact on Kodak's investment plans during the 1970's for the simple reason that Kodak had no investment plans.¹⁰⁸

5.13 The **United States** responds that Kodak could not have had investment plans prior to 1976, because investment was barred by statute. Less than a year after these statutory restrictions were lifted, Kodak established a sales subsidiary.

5.14 According to **Japan**, the so-called "like industries" clause did not prevent joint ventures between manufacturers and distributors. This clause simply required that joint venture partners in Japan were in the same industry as the joint venture itself. This requirement was not applied to foreign companies which formed such a joint venture. Thus, a 50-50 joint venture such as Kodak Nagase in 1986 could have been established as early as 1971. Moreover, a 100 percent wholly-owned subsidiary in the wholesaling sector could have been established after 1973. For whatever reason, Kodak made a decision not to take advantage of these options, and had no intention of exploiting the opportunities it had to develop new distribution channels. Moreover, from 1976 until 1979, a foreign enterprise could purchase existing enterprises outright with the consent of the enterprise being purchased. Such a purchase could occur in the wholesaling sector beginning in 1973 and the photographic materials manufacturing sector beginning in 1976.

5.15 According to the **United States**, Fuji, under the guidance and support of MITI, developed exclusive relationships with its four primary photospecialty wholesalers by 1975 and pressed its exclusive control further down the distribution chain. Fuji, which currently holds a 68-percent market share in Japan, also undertook a successful program, supported by the Japanese Government, to build exclusive relationships with a vast network of photofinishing laboratories. The other Japanese manufacturer, Konica, had exclusive relationships with four long-established primary wholesalers since 1967. Konica "internalized" these wholesalers through acquisition completed in 1987. Konica currently holds a 19-percent market share in Japan.

5.16 The United States argues that, before 1975, Kodak relied heavily on the primary photospecialty wholesalers to distribute its products. In 1975, however, Kodak lost the last of its relationships with a primary wholesaler, leaving Kodak to find other channels into the market outside those used by the Japanese photographic goods manufacturers. As a result, Kodak, which currently holds a 10-percent market share, sells nearly two-thirds of its film in Japan directly to retailers, one-quarter through affiliated photofinishing laboratories, and the rest to secondary wholesalers. Agfa re-entered the Japanese film market in 1990, after an absence of 15 years. The United States alleges that Agfa had left the Japanese market in 1975 in large part because of its inability to recover from its loss of access to the primary wholesale channels in 1968. Unable to use the primary wholesalers when it re-entered the Japanese market, Agfa adopted a strategy of selling directly to retailers, in particular large-scale retailers, in some cases allowing the retailers to market the film under the retailer's brand name (so-called "private brand"). Agfa resorted to private brand sales in an attempt to increase its sales to a limited segment of the market. Because retailers assume the cost of sales promotion for private brand film, Agfa also hoped to lower its distribution costs. Agfa, which currently holds a 3-percent market share - down

¹⁰⁸Japan cites Professor Scherer who noted: "What is striking to this observer, but not pointed out explicitly, is that the events of 1973-75 reflected a colossal failure of intelligence (in the military sense) of Kodak. Kodak apparently had no employee in Japan at the time who could read contemporary Japanese trade press accounts of the Nagase-Asanuma dispute, understand the importance of securing Asanuma as a primary Kodak wholesaler, and intervene to override Nagase's self-serving actions. Not until 1977 did Kodak open a liaison office in Japan staffed by Kodak employees to oversee, inter alia, the activities of Nagase. In sharp contrast were the market opening efforts of Volkswagen and Toyota, who sent their own English-speaking personnel to the United States, first to assess market opportunities and then to implement their entry decisions." F.M. Scherer, Retail Distribution Channel Barriers to International Trade, October 1995, (working paper presented at a Columbia University Conference entitled "The Multilateral Trading System of the 21st Century"), Japan Ex. A-19.

from its 1995 peak of 4 percent - sells 90 percent of its film directly to several large retailers and the remainder through secondary wholesalers.

5.17 **Japan** notes the United States cites no support for its claim that Agfa had left the Japanese market in 1975 largely because of its inability to recover from its loss of access to the primary wholesale channel in 1968. Kodak had introduced a new colour negative process technology, and since Kodak has historically set industry standards, all rivals had to make a choice. Soon thereafter, the two Japanese manufacturers Fujifilm and Konica had matched Kodak's developing standard. Agfa, in contrast, chose to continue with its own standard. With three of the four major manufacturers operating off a compatible standard, Agfa's market position quickly became untenable. This story is well known in the industry. At the time Agfa reentered the market in 1987, the story was reported in the business press.¹⁰⁹

5.18 According to the **United States**, the Japanese market structure was the result of actions by the Government of Japan. Following the 1967 Cabinet Decision discussed below, MITI concentrated its efforts, renewing its call for use of standardized trading terms, promoting the use of shared distribution facilities and computer ties among Japanese producers and distributors, and facilitating the systemization of photofinishing laboratories under domestic manufacturers. Japan's leading photographic material producers, Fuji and Konica, soon adopted such standardized terms with wholesalers. As intended by MITI, the resulting lack of competition among Japan's leading film and paper suppliers resulted in the financial deterioration of the photospecialty wholesalers. Eventually, all of the primary wholesalers agreed to handle products of domestic manufacturers on an exclusive basis.

5.19 The United States argues that before MITI's intervention, foreign manufacturers, though encumbered by quotas and high tariffs, had access to nearly all of Japan's photospecialty wholesalers. Under MITI's direction wholesale operators in the photographic materials sector were consolidated, creating narrow distribution channels under the control of domestic manufacturers. As a result, by the mid-1970's the leading photospecialty wholesalers handled only domestic film and paper, effectively excluding imports from the distribution system. Thus, by early 1975, however, the competitive situation in Japan's consumer photographic materials market had been completely transformed. As of that time, not one major distributor carried imported products. In the span of little more than a decade, foreign film and paper manufacturers had been excluded from the primary avenues of distribution.

5.20 The United States concludes that the result of this manipulation of the market is that today, Japan's materials market is supplied by four manufactures, two domestic and two foreign. The two domestic manufacturers, Fuji and Konica sell almost all their film through "primary" photospecialty wholesalers, which are spread throughout Japan. The primary wholesalers in turn distribute film directly to retail outlets, or through affiliated "secondary" wholesalers, which are smaller and regionally based. Unlike their domestic competitors, the two foreign manufacturers, Kodak and Agfa sell most of their film directly to retail outlets. For the last twenty-two years no primary wholesaler has distributed Kodak or Agfa film.

5.21 **Japan** responds that in these proceedings all that matters is whether there are government-imposed barriers that prevent that market penetration from improving. Japan maintains that there are no such barriers in Japan.

5.22 Japan emphasizes that the aim of MITI's distribution policies was not to block imports, but to modernize the Japanese distribution industry and help it to meet the foreign competitive challenge that would be unleashed by liberalization. Nothing in MITI's distribution policies or any other so-called "liberalization countermeasures" did anything to encourage or facilitate the creation of an exclusionary

¹⁰⁹See, Japan Agfa Gevaert, Advances Into The Japanese Market After An Interval of 15 Years, Takes The Offensive Against Oligopolistic Film Market With Its Low Price, Nikkei Business, 5 December 1988; Top Three Film Makers Move to Cut Prices, Japan Economic Journal, April 16, 1988, p. 21, Japan Ex. B-33.

market structure that discriminates against imported film or paper. Since the MITI policies in question actually say nothing about encouraging single-brand distribution of film, the United States struggles to establish some connection between MITI's policies and the market structure that is the main target of its complaints. When confronted with the actual facts of this market, however, the US arguments about "distribution countermeasures" collapse.

5.23 Japan argues that in the end, the US claim boils down to an assertion that the current Japanese market structure for consumer photographic film and paper is exclusionary and closed, and that this abnormal situation must somehow be the result of government intervention. The fundamental premise of this argument is simply wrong. At the root of the US complaints is the fact that the various primary wholesalers in Japan each carry only a single brand of film. But single-brand wholesale distribution is a normal business practice; for film, this business practice is the norm in every major market in the world, including the United States. The Japanese market for consumer photographic film and paper reflects the outcome of normal market forces.

5.24 Furthermore, Japan asserts that the premise of the US argument that there are barriers, the so-called "distribution bottleneck," in the Japanese film market is wrong. Japan argues that a survey of the primary wholesalers' customers reveals that imports have already thoroughly penetrated these key accounts. Thus, customers accounting for 87.3 percent of the primary wholesalers' combined surveyed sales volume either already carry Kodak or else have ready access to Kodak through established business relationships.¹¹⁰ In particular, the primary wholesalers' survey highlights imports' ability to distribute through multibrand secondary wholesalers in Japan. Of the 278 resellers included in the survey, 52.2 percent -- accounting for 66.4 percent of total surveyed sales volume to those customers -- already carry Kodak film.¹¹¹ Thus foreign brands of colour film are already present at the key levels of the distribution system. The US "distribution bottleneck" argument thus fails the most basic threshold empirical test. Since most of the primary wholesalers' customers already purchase Kodak film from other sources, the "distribution bottleneck" clearly does not exist.

5.25 Japan notes that if the Panel adopts the view that a key factor is the degree of imports' market penetration, foreign market share in fact increased after the introduction of the alleged measures that created the so-called bottleneck. According to Japan, it is clear that subsequent to 1975, when according to the United States the competitive situation in the Japanese film market had been completely transformed, the market share of foreign colour film actually continued to increase to a record 20.0 per cent in 1981. The market share for foreign black and white film increased even more dramatically, peaking at a record 41.4 per cent in 1985. This trend in foreign film market share directly undermines the US "bottleneck" theory.

5.26 On Japan's argument concerning market shares for black and white film, the **United States** responds that Japan's liberalization countermeasures were and are directed at *consumer* photographic film and paper, whether black and white, or colour. Until 1970-1972, black and white was the predominant consumer film (and paper) used in Japan, thereafter it was colour.¹¹² Accordingly, Japan's focus on recent market share data on black and white products is not relevant. Given that black and white film (and paper) was the dominant product at the time the Government of Japan began pursuing liberalization countermeasures, and that the Government recognized that colour would surpass black and white at some time in the near future, the Government directed the liberalization countermeasures at obstructing the distribution and sale of *consumer* photographic film and paper, whether black and white, or colour.

¹¹⁰Fujifilm's Rebuttal Regarding the Alleged "Distribution Bottleneck," 21 December 1995, p. 5, 7, Japan Ex. A-16.

¹¹¹Ibid., p. 25, Japan Ex. A-16.

¹¹²Until 1970-72, black and white film and paper were the predominant products used in Japan. Thereafter, the dominant products were colour film and paper. Today, colour film and paper account for 97 percent of Japan's total market for consumer photographic materials, with black and white film and paper accounting for only 3 percent.

5.27 **Japan** asserts that even at the current market share level of roughly 15 per cent for colour film, there is nothing unusual about the foreign market share for this industry. Japan notes that in markets outside the United States and Japan, Kodak and Fuji have comparable market shares but each has an almost equal and large share of its home market. In its view, ultimately, market shares reflect consumer preferences. Fuji's survey show that consumers perceive Fuji brand film to be of a higher quality, ranking it higher than Kodak on most qualitative measures.¹¹³ Consequently, Fuji film enjoys very strong brand loyalty among Japanese consumers. Among American consumers the same general perceptions apply to Kodak film. In other words, the resulting market situation is not a result of any Japanese government policies. Finally, Japan notes that the domestic brands overwhelmingly outspend foreign brands in advertising expenditures in the Japanese market, another factor which has a significant impact on consumer and retailer preferences.

5.28 The **United States** responds that Japan's argument that Japanese domestic brands overwhelmingly outspend foreign brands in advertising expenses is flawed in three respects: (a) Japan adds Fuji's and Konica's expenditures, suggesting that Kodak should have outspent two companies combined; (b) Japan bases its calculations on total advertising figures, not weighted by sales, suggesting that a company with 10 percent of the market should match, yen-for-yen, the combined expenditures of two firms holding 87 percent of the market; and (c) Japan compares the advertising expenditures made by Fuji and Konica for all products to Kodak's advertising expenditures for film only. The Economist magazine estimates that Kodak's advertising expenditures were triple those of the Japanese manufacturers during the period cited by Japan.

5.29 **Japan** points out that the United States fails to take note of key distinctions between black and white and colour products. According to Japan, the foreign share of black and white film has been quite high, and has been growing over time. Over the past ten years, on a volume basis the foreign market share of black and white film has averaged 24 percent, ranging from 19 percent to 37 percent. Japan further contends that the foreign market share for black and white paper has also been quite high, ranging between 31 and 55 percent. Japan, therefore, argues that it is hard to reconcile this market reality with the United States' allegations. According to Japan, Japanese manufacturers sell their colour film and black and white film through the same primary wholesalers that comprise the supposed "bottleneck" facility for colour film. The alleged "bottleneck" apparently has not affected the ability of foreign brands to sell their black and white film, a factor which Japan contends fundamentally calls into question whether there is really any "bottleneck" at all.

5.30 The **United States** contends that the net effect of the liberalization countermeasures has been, as was intended, the creation of a market structure that impedes the sale of imports. The structure remains in place today. The United States further asserts that despite the elimination of quotas, tariffs, and investment restrictions, as well as significant efforts by foreign enterprises to compete in Japan, the market share for imported film and paper has been stagnant for the past decade. A succession of technological innovations and major investments by foreign manufacturers has yielded limited results. For example, Kodak has reduced its prices in the Japanese market by 56 percent since 1986 and has substantially undercut domestic wholesale prices, with virtually no effect on the market.

5.31 According to **Japan**, if Kodak in fact dropped its wholesale price by such large margins, with no appreciable effect on its market share, Kodak obviously has severe brand image problems in Japan. Japan asserts that retailers must believe that Japanese consumers are completely indifferent to Kodak; otherwise, such a huge gap in wholesale prices would give retailers an enormous incentive to cut the price of Kodak to stimulate demand, and increase the volume they would sell of the much more profitable product. In addition, Japan asserts that the United States must believe that Japanese consumers are completely irrational. In addition, for Japan it is noteworthy that for the past several years, Kodak's

¹¹³Annual Report on Consumer Image Survey, Japan Marketing Research, Japan Ex. A-3.

manufacturer's suggested retail prices for ISO 100 and ISO 400 consumers have generally been identical to Fuji's (on occasion they have been higher). Thus, for the past several years Kodak has been telling retailers that it would like Kodak film to have exactly the same price as Fuji film. This fact is inconsistent with the United States claim that Kodak has been stymied in its attempts to underprice Fuji film. Indeed, according to Japan, Kodak has publicly stated in the late 1980's and early 1990's that it does not want to compete on prices in Japan.

5.32 The **United States** counters that Kodak and retailers carrying Kodak products have been under pressure from the JFTC and JFTC-sanctioned councils to maintain stable retail prices. Discount initiatives have been suppressed.

3. *NEED FOR PRIMARY WHOLESALERS IN THE JAPANESE FILM MARKET*

(a) The US allegations about the market situation in the film distribution sector

5.33 According to the United States, there are 280,000 retailers selling photographic materials across Japan. This large number of retail outlets that sell film makes it difficult for any manufacturer to distribute film without access to the primary wholesalers. Direct sales to retailers can provide only limited access to a small portion of the market.

5.34 The United States asserts that one-half of all retail film sales by volume are through some 30,000 traditional photospecialty stores, whose primary, if not only, line of business is the sale of film, cameras, and accessories. Most of these photospecialty stores, which range from small "mom and pop" stores to somewhat larger stores with multiple outlets, do not carry imported film. The same primary wholesalers that distribute film to these specialty stores also supply them with cameras and other photographic products. Photospecialty retailers have close and longstanding relationships with the photospecialty wholesalers. Because these primary wholesalers do not carry imported film, the photospecialty stores cannot purchase imported film from these traditional suppliers. Nor are the photospecialty stores inclined to purchase imported film from an alternative source. Photospecialty retailers rely on the primary wholesalers for timely delivery of virtually all the store's products and are not likely to jeopardize that relationship by purchasing imported film from another distributor. The United States accordingly concludes that access to the primary wholesalers is critical for selling imported film to the photospecialty retailers.

5.35 The United States indicates that another third of film sales are through 70,000 general merchandise stores, including supermarkets and discount, department, drug, and convenience stores. It is the US view that the larger types of these stores are more likely than small stores to carry competing brands of film. Some of the largest of these retail outlets have their own distribution facilities, which reduces their dependence on wholesalers and allows them to deal directly with manufacturers.

5.36 The United States also notes that there are approximately 180,000 other retail outlets for film in Japan, including kiosks, tourist resorts, parks, and other small outlets. Their small size and geographic dispersion makes it highly inefficient to attempt to reach them except through the wholesalers currently serving them.

5.37 The United States argues that only the photospecialty wholesalers have the geographic presence, distribution infrastructure, sales networks, and personnel to reach and provide service to Japan's numerous retail outlets. In addition, because primary wholesalers carry a wide range of complementary products, they have high economies of scale in marketing and delivery functions. These wholesalers perform more than a logistical distribution function for manufacturers. The United States concludes that Fuji's exclusive access to Japan's largest primary photospecialty wholesalers provides it with an unfair edge over its foreign competitors.

5.38 The United States further argues that Japan's "secondary" photospecialty wholesalers are much smaller than the primary wholesalers and operate on a local or regional scale, and can, therefore, only provide limited geographic reach. Even if such wholesalers represented viable alternative distribution channels for film, many are not commercially independent from domestic photographic materials manufacturers. Several of the top secondary wholesalers have joint physical distribution and affiliated photofinishing laboratory operations with Japanese manufacturers or manufacturer-dominated primary wholesalers. These ties have impeded foreign manufacturers from gaining access to secondary-wholesaler channels as an alternative to primary wholesale channels.

5.39 According to the United States, photofinishing laboratories provide only a limited alternative to the primary wholesalers. Laboratories are, in the first instance, the primary market for photographic paper and photofinishing chemicals. However, they also can act as wholesalers for film and other products because they frequently and regularly make rounds to retailers in order to pick up exposed film and deliver processed prints. In the process of making these regular stops, the photoprocessing laboratories can distribute film and other photographic supplies to the retailers. In Japan, however, 84 percent¹¹⁴ of the 1,700 photoprocessing laboratories deal exclusively in the film and paper of a Japanese producer.¹¹⁵

5.40 The United States alleges that experts on distribution and competition policy in Japan agree on the importance of access to the wholesale system for access to the market.¹¹⁶ The leading history of Fuji also emphasizes that Fuji sees its four primary wholesalers not simply as a vehicle for delivering products to market, but as "a mechanism that would maintain high market shares".¹¹⁷

(b) No government obstacles to use or creation of primary wholesalers

5.41 **Japan's** response is that in the first place, if a foreign manufacturer is dissatisfied with the quality of its distribution system for film and paper in Japan, there is nothing that would prevent it from taking steps to improve matters. There are no current government measures preventing the foreign manufacturer from hiring more sales people, offering lower prices, or spending more on advertising. Further, there are no current government measures preventing a foreign manufacturer from acquiring other distributors or photofinishing laboratories if they were for sale. And further, there are no current government measures of any kind that would in any way stop a foreign manufacturer from expanding or improving its distribution network.

5.42 Japan emphasizes that, in particular, there are no government measures that prevent foreign manufacturers from attempting to establish relationships with independent primary wholesalers that currently choose to carry only a single brand. According to Japan, the United States has not even attempted to identify any such government measures. In fact, there is no legal obstacle blocking such relationships. Japan asserts that Fuji's contracts with its primary wholesalers do not contain any provisions that prohibit or discourage the carrying of other brands.¹¹⁸ Japan further asserts that some

¹¹⁴Japan challenges the conclusion that 84 percent of laboratories in Japan fall under the umbrella of a Japanese producer. According to the data given in Photo Market 1996, of the 753 amateur laboratories in the Japanese market, 292 laboratories (38.8 percent) are affiliated with Fuji, 124 laboratories (16.5 percent) are affiliated with Kodak, 216 laboratories (28.7 percent) are affiliated with Konica, and 121 laboratories (16.1 percent) have other affiliations.

¹¹⁵Photo Market 1996, US Ex. 96-1.

¹¹⁶Tajima Yoshihiro, *Japan's Market and Distribution System: Japanese Distribution Channels*, edited by Kikuchi Takeshi, (London: Hawath Press, 1994), p. 3, US Ex. 94-3.

¹¹⁷Arai Toru, *Shisi No Honryo: Fuji Film (Characteristics of a Lion: Fuji Film)*, (Tokyo: BNT Books, Nikkan Kogyo Co., 27 January 1995), US Ex. 95-8.

¹¹⁸According to Japan, the contracts between Fuji and its primary wholesalers previously contained provisions requiring the wholesalers to seek Fuji's permission before carrying other brands. In 1981, Fuji voluntarily removed these provisions. Affidavit of Tanaka Takeshi, p. 3, Japan Ex. A-10.

of Fuji's primary wholesalers do currently sell Kodak products.¹¹⁹ Those wholesalers decide to carry only Fuji film not because they are forced to do so by the Government of Japan, or even by Fuji, but because they believe a single-brand strategy serves their business interest. One of Fuji's four primary wholesalers, Asanuma, became a single-brand distributor after Kodak explicitly refused to deal with it directly.

5.43 In response, the **United States** explains that Japan has taken several recent steps to reinforce its distribution countermeasures. Some of these steps include "administrative guidance," and some include more formal measures. Moreover, the administrative guidance issued in the past remains in effect because Japan has not revoked or counteracted it, and Japanese industry continues to act in accordance with it. Specifically, Japan has not revoked or attempted to counteract its administrative guidance in favour of short payment terms, standardized transaction terms, rebates and volume discounts, and vertical information links between manufacturers, wholesalers, and retailers. To the contrary, Japan has issued recent administrative guidance making clear that its policies remain in place regarding each of these. Japan also has continued to apply formal measures to support the oligopolistic distribution system in the photographic film and paper industry.

5.44 In **Japan's** view, Kodak has never seriously approached the single-brand primary wholesalers with a serious business proposal. Japan submitted affidavits from each of the four major primary wholesalers attesting that Kodak has not made serious business proposals.¹²⁰

5.45 The **United States** argues that on several occasions in 1987-1991, 1995, and 1997 (in addition to earlier decades), Kodak approached the four primary wholesalers to seek a distribution arrangement, and was rebuffed. The United States understands that Agfa approached these wholesalers in recent years and was rebuffed as well. Japan's distribution countermeasures have limited the wholesalers' incentives and freedom to deal in foreign products. In addition, Kodak has also repeatedly approached secondary wholesalers to deal in its products, but frequently has been rebuffed. The secondary wholesalers do not have the scale or market coverage of the primary wholesalers, but full access to one or more of them would still increase the access to retail of imported film and reduce the relative cost of distributing it. However, the countermeasures have increased control or influence over the secondary wholesalers by the manufacturers/primary wholesalers and helped prevent the development of a significant relationship with Kodak or Agfa. Kodak has aggressively sought to expand film sales through the photofinishing laboratory channel, but is able to sell only about one-quarter of its film through this channel. Kodak faces constraints in further expanding its sales of paper to laboratories and distribution of film through laboratories because many laboratories have exclusive relationships with Japanese manufacturers.¹²¹

5.46 In considering Japan's recent formal and informal actions, the United States points out that it is important to recognize that the distribution structure set up by the measures beginning in the 1960s and 1970s is, to a large extent, self-sustaining. Once Japanese manufacturers achieved domination over the distribution system through implementation of short payment terms, rebates and discounts, vertical information links, and other measures advocated and implemented by the Japanese Government, the manufacturers' power allows them to maintain such domination, through the continuing use of these transaction terms and other mechanisms, with less need for support from the Japanese Government. A reduced need for support does not mean that the Government reversed its policy. To the contrary,

¹¹⁹Japan asserts that both Asanuma and Kashimura carry Kodak slide products. In addition, Japan asserts that Asanuma has a retail subsidiary in Tokyo that sells Kodak film. Affidavit of Takenosuke Katsuoka, p. 4, Japan Ex. A-11; Affidavit of Tomihiko Asada, p. 3, Japan Ex. A-12.

¹²⁰See Affidavit of Takenosuke Katsuoka, Japan Ex. A-11; Affidavit of Tomihiko Asada, Japan Ex. A-12; Affidavit of Yuki Yoshi Noro, Japan Ex. A-14; Affidavit of Kaoru Konno, Japan Ex. A-15. Japan also notes that Kodak film has actual access to secondary wholesalers and retailers. See Section V.A.3.(d), paras. 5.57-5.59.

¹²¹See Affidavits of Sumi Hiromichi, US Ex. 96-10, and William Jack, US Ex. 97-2.

Japan has continued to advocate short payment terms, rebates and discounts, and vertical information links, and Japanese manufacturers and wholesalers have continued to apply these practices to maintain the oligopolistic distribution system. Moreover, the Government of Japan has continued to suppress alternative channels and potential challenges to this system, such as large stores and independent photoprocessing laboratory networks, thereby shielding the oligopolistic distribution system from competitive pressures that could undermine it.

5.47 With this context in mind, the United States notes continuing actions by the Japanese Government to implement its transaction terms and vertical information links policies. For example, in the 1980's, Japan, *inter alia*: developed new business assistance programs to bolster the systemization of laboratories and exclude imports of both film and paper from this alternative channel; pressed forward with strengthening the informational ties between manufacturers and wholesalers; and continued to rely upon chambers of commerce in ongoing application of standard transaction terms. More recently, MITI's 1990 Guidelines affirmatively advocated the use of rebates: "[w]hen there are clear payment standards on rebates, this practice of rebate payment has its merit. ..." ¹²² Similarly, in 1993, MITI's Small and Medium Enterprise Agency (SMEA) and a confederation of wholesalers trade associations, including the photospecialty wholesalers association, jointly conducted a study and published a report addressing issues raised in MITI's 1990 Distribution Guidelines. ¹²³ Based on the report, SMEA drafted a model wholesaler's contract. ¹²⁴ The 1993 SMEA Report notes that such practices "have been formed to facilitate the transaction relationship between businesses ... and are thought to go on for a certain economic reason among the transacting parties and the industry that they belong to." ¹²⁵ Nowhere does the report or the model contract mention any elimination of the use of rebates, or provide any instruction to follow up or implement the 1990 Guidelines' caution against the use of rebates for "maintaining a keiretsu-based relationship." Instead, only the 1990 Guidelines' favourable mention of rebates is reflected in 1993 SMEA Report and contract.

5.48 In addition, the United States points out that the 1993 SMEA Report and model contract demonstrate that Japan continues to support the standardization of transaction terms among photographic materials wholesalers which help maintain exclusive vertical relationships in the distribution system, established as a result of the liberalization countermeasures program. The report noted with approval that "retail industry associations and all industries are working in various ways to standardize business practices." ¹²⁶ The report admonished, however, that "problems still remain unchanged" and "[t]he need for improvement is becoming stronger." ¹²⁷ Later the report again stressed, "ways to clarify and

¹²²Guidelines for Improving Business Practices, p. 2, US Ex. 90-5.

¹²³MITI, Small and Medium Enterprise Agency, Wholesale Industry - Current Status and Future Issues 1993, 20 September 1993 (1993 SMEA Report). Second Panel Questions and US Answers, US Ex. 1. The Confederation of Small- and Medium-Sized Wholesale Industry Related Trade Associations (SMEA Wholesalers' Confederation) was established in August 1990 as an informal advisory body to the Director-General of the Guidance Department of SMEA. *Ibid.*, p. 6. The Federation of Photo Wholesalers (Shashoren) is a member of the confederation. *Ibid.*, p. 8, see Tab 1. This process followed MITI's classic public-private sector cooperation method (Kanmin kyocho taisei) in which the government and industry jointly develop measures based on the concerted adjustment process. The United States points out that the government-private sector cooperation method establishes incentives and disincentives to ensure industry compliance with MITI's policy.

¹²⁴The model contract calls for cash payment on a monthly basis. Article 8 of the SMEA Model Contract, reprinted in 1993 SMEA Report, p. 78. Second Panel Questions and US Answers, US Ex. 1. The model contract provides that in those cases where cash payment is not possible, notes should have a limited term and interest should be charged for late payment. This model contract demonstrates that MITI's policies and guidance remain unchanged regarding payment terms. SMEA drafted the model contract working with the Institute of Distribution Research (which drafted the March 1969 Survey of transaction terms, which provided the basis for the 1970 MITI Guidelines) and the Distribution System Development Center (which has played a critical role in the implementation of MITI's systemization policy). 1993 SMEA Report, p. 75. Second Panel Questions and US Answers, US Ex. 1.

¹²⁵1993 SMEA Report, p. 4. Second Panel Questions and US Answers, US Ex. 1.

¹²⁶*Ibid.*, p. 5.

¹²⁷*Ibid.*

standardize transaction terms should be studied. ..."¹²⁸ In addition to these calls for standardization, the act of preparing and publishing a standard contract was in itself an act promoting standardization.

5.49 The United States also presents evidence to document that MITI, throughout the late 1970s and the entire 1980s, has continued to promote and resolve technological issues related to vertical information links. When Japan overcame the remaining technical hurdles in 1989, Fuji immediately created technical links up with its distributors. Japan has never revoked or worked to counteract its administrative guidance in favour of vertical information links between manufacturers, wholesalers, and retailers. Moreover, since 1989, Japan has continued to make clear that vertical electronic integration of distribution is official policy. For example, MITI's 1990 Guidelines advocated vertical information links between manufacturers, wholesalers, and retailers.¹²⁹ Fuji continues to be electronically linked to distributors, giving Fuji a wide variety of information over the distributors' activities and increasing Fuji's efficiency and its control of distribution. None of Fuji's competitors has access to the information network among the supposedly independent distributors in this chain.

5.50 According to the United States, in addition to maintaining its administrative guidance concerning transaction terms and information link policies, Japan also has continued to support the oligopolistic distribution structure in the photographic materials industry with formal measures. The most important of these is the Large Stores Law. Similarly, Japanese manufacturers continue to be the principal beneficiaries of SMEA subsidy programs for photoprocessing laboratories, because the bulk of such subsidies are provided to photoprocessing laboratories affiliated with domestic manufacturers.¹³⁰ Finally, the 1995 Business Reform Law opened the door for continued active government assistance to buttress the oligopolistic distribution structure in the photographic materials industry by providing Japan with a broad legal framework to assist "domestic production activities" and to implement MITI distribution policy.¹³¹

(c) **The role of Nagase and Kodak Japan**

5.51 **Japan** further asserts that the US argument ignores the existence of Kodak's primary wholesaler, Kodak Japan (formerly Nagase and then Kodak-Nagase). Japan argues that by collapsing Kodak, the manufacturer, with its wholesaler subsidiary, the United States creates the impression that the domestic manufacturers have access to a distribution channel (i.e., primary wholesalers) that imports lack. This impression, however, is not supported by the facts. Long ago Nagase, then Kodak's exclusive importer, sold film to some of the domestic manufacturers' primary wholesalers. However, Nagase also acted as a primary wholesaler itself, thereby competing with its own customers. This conflict intensified in 1967, when Nagase acquired a multibrand primary wholesaler, Kuwada, and transformed it into a single-brand Kodak distributor.

5.52 The **United States** responds that Kodak does business through its wholly-owned subsidiary, Kodak Japan, Ltd., which performs technical support, product development and marketing tasks. Lacking access to wholesale channels, Kodak Japan necessarily sells Kodak film directly to retail outlets. That fact does not render it a "wholesaler"; were that the case, arguably any subsidiary of a foreign company in Japan could be transformed into a "wholesaler" merely by excluding it from distribution channels.

¹²⁸Ibid., p. 73.

¹²⁹Guidelines for Improving Business Practices, p. 9, US Ex. 90-5.

¹³⁰MITI Industrial Structure Division, Special Measures Law to Promote Business Reform for Specified Industrialists, Law No. 61 of 1995, Article 2, US Ex. 95-1.

¹³¹Ibid., Article 1, US Ex. 95-1.

5.53 **Japan** responds that Kodak itself has pointed out in other contexts¹³² that Kodak Japan performs essentially the same functions as the primary wholesalers. Indeed, Kodak Japan sells to the same customers as Fujifilm's primary wholesalers and performs the same services for these customers as do the primary wholesalers. The history of Kodak's distribution in Japan also demonstrates Kodak Japan's role as a primary wholesaler. From the 1960s until 1977, Kodak relied exclusively on its import agent Nagase for distribution functions. Kodak clearly believed that Nagase, particularly after its acquisition of a primary wholesaler, Kuwada, was its wholesaler in Japan, and that Nagase was fully capable of performing the wholesaling function.¹³³

(d) Single brand distribution does not impede access of imports

5.54 According to Japan, the US case rests critically on a false assumption about the distribution structure in Japan, i.e., that domestic manufacturers' relationships with primary wholesalers have created a "distribution bottleneck" that hinders imports' access to Japanese retailers. Japan argues that the United States assumes that because there are nearly 280,000 retail outlets that sell film in Japan, then it necessarily follows that direct distribution to all of these retailers is impractical and that access to these primary wholesalers' comprehensive distribution networks is, therefore, allegedly essential if imported film is to penetrate the Japanese market fully. Japan retorts that the US argument completely misunderstands how film is distributed in Japan, particularly the role of primary wholesalers. Moreover, the United States incorrectly calculates the availability of imported film at Japanese retailers.

5.55 Japan notes that since each of the three brands is sold by the manufacturer to single-brand primary wholesalers, it follows of necessity that the brands do not share primary wholesalers. This does not mean that imports lack access to the primary wholesaler distribution channel. Rather, the different brands simply utilize different primary wholesalers. Japan further asserts that in addition to ignoring import's access to the primary wholesale channel, the United States exaggerates the role of primary wholesalers. Although it is true that there are 280,000 retail outlets that sell film in Japan, all but 13,445 of the outlets buy their Fuji brand film not from the primary wholesalers, but from secondary wholesalers or laboratories. Fewer than 5,000 accounts collectively cover virtually the entire Japanese market. The United States offers no reason why Kodak's single-brand primary wholesaler, Kodak Japan, would be incapable of servicing these 5,000 key accounts.

5.56 The **United States** replies that even if this number were correct, Fuji needs four large primary wholesalers to service these 5,000 accounts. Because the foreign manufacturers have no access to the primary photospecialty wholesalers or to many of the secondary wholesalers that service these accounts for Fuji, they have to service these accounts directly. Direct distribution or other alternative channels created by foreign firms provide them with access to only a limited segment of the market, specifically in central neighbourhoods or large cities - areas where photospecialty outlets are relatively large and densely located.

5.57 **Japan** also notes that the same survey of the primary wholesalers' customers reveals that imports have already thoroughly penetrated these key accounts. Of all the accounts surveyed, 62.0 percent -- accounting for 77.3 percent of the primary wholesalers' combined surveyed sales volume -- currently carry Kodak brand film. Another 16 percent -- accounting for 10.0 percent of surveyed volume -- either buy other non-film products from Kodak or else conduct regular business with secondary wholesalers or photofinishers that sell Kodak products. Thus, customers accounting for 87.3 percent of the primary wholesalers' combined surveyed sales volume either already carry Kodak or else have

¹³²See Exhibit 1 of Japan's June 1997 Presentation Materials for the second substantive meeting with the Panel (providing chart from Dewey Ballantine for Eastman Kodak Company, "Privatizing Protection," May 1995.)

¹³³Japan notes the United States confuses Kodak Japan and Eastman Kodak Japan. Eastman Kodak Japan was originally established as "Kodak Japan" in 1977, but was later renamed in 1989. Although Eastman Kodak Japan performs both marketing and technical services, and is not a wholesaler, Kodak Japan functions as a primary wholesaler in the Japanese market.

ready access to Kodak through established business relationships. According to Japan, the United States concedes that Fuji and its primary wholesalers have more sales people than Kodak Japan. If Kodak wants to improve its distribution, however, there is no legal obstacle to hiring more sales people. The relative strength of Kodak's sales effort is entirely up to Kodak. Furthermore, Japan asserts that the United States has overstated the number of sales people at Fuji's primary wholesalers by approximately 50 percent.

5.58 Japan asserts that Kodak's own data prove the point. Japan points out that according to a survey of Japanese retailers commissioned by Kodak for the US Section 301 investigation, approximately 50 percent of photo shops surveyed carry Kodak.¹³⁴ Japan's position is that photo shops, which presently account for almost half of total film sales in Japan,¹³⁵ are the "traditional distribution channel" supposedly dominated by domestic manufacturers' primary wholesalers.

5.59 Japan therefore argues that the US "distribution bottleneck" argument thus fails the most basic threshold empirical test - if most of the retailers and secondary wholesalers that purchase film from Fujifilm's primary wholesalers did not carry imported film, then there would at least be an argument that the lack of a relationship between foreign manufacturers and those primary wholesalers was causing imports to lose sales. But since most of the primary wholesalers' customers already purchase Kodak film from other sources, the "distribution bottleneck" clearly does not exist. Kodak's own primary wholesaler, Kodak Japan, can and does sell film directly to the largest retail accounts. Kodak Japan can and does sell film to secondary wholesalers - not to mention its own affiliated photofinishing laboratories - which then distribute to smaller retailers. Therefore, there is no market barrier preventing imports' access to retailers.

5.60 The **United States** responds that an analysis of the survey from which the 90 percent figure is allegedly derived shows discrepancies between the actual survey results and the figures reported in Japan's submission. Inspection of the survey also reveals that it used biased survey and sampling techniques. Therefore, the United States urges the Panel to accept the Kodak survey, which shows that Kodak film is actually available in about 40 percent of the stores in Japan.

5.61 The United States argues that Japan's survey is flawed because the determination of whether a retailer carries foreign film is based on asking Fuji's four primary wholesalers to ask their customers whether they had access to foreign film. The United States points out that about one-third percent of the primary wholesalers' film sales are to other secondary wholesalers. Some of these wholesalers deal with a very large number of retail customers. According to the United States, Japan's own submissions to the Panel report that 278 of the secondary wholesalers sell to tens of thousands of retail customers. Accordingly, under Japan's survey, if one of those secondary wholesalers had purchased one roll of foreign film to sell to just one of those tens of thousands of retailers, Japan would conclude that foreign film had access to all of those tens of thousands of retailers. The United States argues that this methodology severely distorts the view of the market access situation.

5.62 The United States further points out that the above example of token dealings by wholesalers in Japan should not be considered an exaggeration. The GATT itself found, in its Trade Policy Review of Japan, that keiretsu manufacturers tend to discourage, but not always prevent, their wholesalers from dealing in a competitor's products.¹³⁶ Consistent with this finding, the four primary wholesalers have been known to occasionally engage in token dealings of foreign film. For example, in 1995, the four primary wholesalers together sold 295 rolls of Kodak film. The total sales of these four primary wholesalers that year were approximately 25 million rolls. Applying Japan's survey methodology,

¹³⁴Japan Market Access Survey for Photographic Film, 20 March 1996, p. 2, Japan Ex. A-20. The same conclusion can be found in the Hester affidavit provided by the United States in this proceeding. US Ex. 97-9.

¹³⁵Photo Market 1996, p. 130, Japan Ex. A-1.

¹³⁶C/RM/S/57 p. 93.

it could be concluded that foreign film had access to 100 percent of Japan's retailers in 1995 because the four primary wholesalers reach 100 percent of the retail customers in Japan. Clearly, however, 295 rolls out of 25 million does not constitute access to the distribution system.

5.63 In the US view, the important question is how many retailers in Japan in fact carry foreign film, since it is the retailers who ultimately sell to the end users. According to the United States, Japan, however, did not analyze access to the retail market for the Panel. Responding to a question from the United States at the first Panel hearing, Japan did provide the raw data for one of its market access surveys. These data reveal that foreign film is available in 43 percent of the retail outlets in Japan. The United States believes this figure is high, since the sample of the survey was biased heavily toward major cities, where foreign film is more prevalent, and the study was otherwise infected with other sampling and methodological errors. Still, the 43 percent figure reveals substantially less market access than Japan claimed, and is close to the 40 percent figure found in the US study.

5.64 **Japan** responds that the United States attacks the survey sampling methodology, yet apparently forgets that the survey of wholesaler customers was not a sampling at all. Rather, over 95 percent of the customers, virtually the entire customer base, were surveyed. There can be no issue of "sampling bias" when the entire universe is surveyed.

(e) The market for paper

5.65 According to Japan, the United States claims that MITI's distribution policies served to encourage and facilitate primary wholesalers' switch from multibrand to single-brand wholesale distributors, thereby supposedly creating a distribution bottleneck and excluding imported film and photographic paper from access to the hundreds of thousands of Japanese film retailers. Japan asserts that this theory does not even address photographic paper. Japan maintains that although the US complaint supposedly pertains to photographic film *and* paper, the US theory has nothing to do with consumer photographic paper.

5.66 Japan further argues, that in addition, photographic paper is distributed through very different channels from those used for film. In particular, the domestic film manufacturers' primary wholesalers are not significant dealers of photographic paper.¹³⁷ Domestic manufacturers distribute their photographic paper through sales subsidiaries or other affiliated companies; these subsidiaries or affiliated companies in turn sell the photographic paper either directly or, in limited amounts, through secondary wholesalers, to the photofinishing laboratories and minilaboratories that use photographic paper to make prints. Accordingly, Japan concludes that, the US theory that the domestic manufacturers' primary film wholesalers create a "distribution bottleneck" is inapplicable to paper.

5.67 Japan further notes that, since the "distribution bottleneck" theory is inapplicable, the only United States argument with respect to paper is that domestic manufacturers' affiliations (through contracts or equity investments) with photofinishing laboratories have created a captive market that foreign paper producers are unable to penetrate. Japan points out that, however, Kodak operates through the same kinds of distribution channels as those used by domestic manufacturers. Japan's position is that the domestic paper manufacturers - Fujifilm, Konica, Mitsubishi, and Oriental - have longstanding networks of affiliated photofinishers that began back in the early 1960's, while Kodak has had a photofinishing presence in Japan for over 40 years: Toyo Genzosyo, an affiliate of Nagase, first began developing Kodak consumer photographic film in Japan in 1952. Until the 1980's, Kodak relied on Toyo's (later renamed Imagica) network of laboratories by establishing a joint venture company, Kodak-Imagica, with Imagica in 1987. According to Japan, today Kodak has affiliations with 124 amateur laboratories,¹³⁸ located all over Japan. Japan explains that in addition to affiliated laboratories, there

¹³⁷Japan's assertion is that Fuji's primary wholesalers account for less than 10 percent of Fuji's total colour photographic paper sales. Affidavit of Tanaka Takeshi, p. 2, Japan Ex. A-10.

¹³⁸Photo Market 1996, p. 198, Japan Ex. A-1.

are a number of non-affiliated minilaboratories. The minilaboratory sector occupies a large portion of the paper market: approximately 60 percent of total paper sales in Japan are to minilaboratories.¹³⁹ As is the case with film, Kodak sells paper through exactly the same distribution channels as domestic manufacturers. There is no "distribution bottleneck" for paper, either.

5.68 The **United States** responds that MITI recognized that foreign manufacturers could circumvent the distribution bottleneck for photographic materials through photoprocessing laboratories. The 1969 MITI-commissioned survey of transaction terms in the photographic sector notes as potential threats "if the oligopoly of the two domestic manufacturers is broken up by a foreign company," and "if a new [distribution] route emerges to compete against the route of photographic material dealers, which is the core existing route in the distribution market."¹⁴⁰ The survey further warned that "foreign companies have already provided financial assistance to the processing industry" and advocated taking steps "to minimize the anticipated disorder in the distribution market."

5.69 The United States further notes that among the recommended measures were, "subsidize the processing industry."¹⁴¹ Subsidies would help tie the laboratories into exclusive relationships with the domestic Japanese photographic film and paper manufacturers and consequently impede the sale of imported paper.¹⁴² A laboratory with one company's photoprocessing equipment is likely to purchase photoprocessing paper and chemicals from that same company, as well as its film, to ensure compatibility and to meet consumer expectations for consistency between the brand of film and paper used. Therefore, a laboratory that uses Fuji equipment often will use Fuji paper and chemicals, and if it distributes film, it likely will be Fuji, which in turn impeded the sale of imported paper.

5.70 According to the United States, in the late 1960s and early 1970s, SMEA provided approximately 160 million yen to assist Japanese film manufacturers in converting black and white to colour photo processing laboratories.¹⁴³ In July 1967, SMEA approved "colour film development and printing laboratories" as one of four sectors deemed eligible that year for subsidized loans. The Chairman of the All Japan Federation of Colour Laboratories Association, who also was the president of Fuji Colour Service,¹⁴⁴ stated that "the main purposes of the laboratory industry becoming designated industry are ... as capital liberalization countermeasures, to modernize facilities and thereby solidify the foundations of businesses."¹⁴⁵ In 1968 the director of MITI's Small and Medium Enterprise Agency (SMEA) called for applying SMEA programs to improve the structure of medium and small businesses in light of "advancing capital liberalization" and as "protective countermeasures against the selling of oneself to foreign capital."¹⁴⁶ When the laboratories were designated as eligible for another SMEA subsidy program in 1973, the chairman of the laboratories association again stressed the need to respond to trade liberalization.¹⁴⁷

¹³⁹Ibid., p. 173.

¹⁴⁰Institute of Distribution Research, Fact-Finding Survey Report Pertaining to Transaction Terms: Actual Conditions of Transaction Practices in the Wholesale Industry, March 1969, pp. 1-21, 287-319, US Ex. 15.

¹⁴¹Ibid.

¹⁴²Ibid.

¹⁴³SMEA played a leading role in providing company-specific financing, consulting, guidance, and monitoring in support of Industrial Structure Council Distribution Committee's liberalization countermeasures. White Paper on Small and Medium Enterprises by the SMEA 1967, US Ex. 67-1.

¹⁴⁴The United States notes that all chairmen of the All Japan Federation of Colour Lab Association (Lab Association) have been Fuji employees: Murakami Eiji (1965-1978), Koseki Yasuo (1978-1988), Takeuchi Hiroshi (1988-1992), and Miyata Hidenobu (1992-present).

¹⁴⁵Murakami Eiji, The Decision on Joseiho [Assistant] Designated Industry, JCFA News, Special Issue, 1967, p. 4, US Ex. 9.

¹⁴⁶Otsutake Kenzo, Main Points of Fiscal 1968 MITI Policy; New Policy Dealing With Capital Liberalization; Approach to Policy on Small and Medium Enterprises, Tsusan Journal, December 1967, Vol. 2 No. 2, pp. 10-15, US Ex. 12.

¹⁴⁷Murakami Eiji, A Year of Trial, JCFA News, 1 January 1973, No. 34, p. 2, US Ex. 27.

(f) Other film markets

5.71 **Japan** argues that in other specialty film products, Kodak itself has experienced significant market success in spite of its reliance on single-brand distribution. In X-ray film, for example, Kodak has an approximately 20 percent share of the market, yet almost all its major wholesalers are exclusively single-brand distributors (the exception, Suzuken, will handle other brands upon request).¹⁴⁸ Fuji sells through Fuji Medical Systems to several distributors, in two of which Fuji has equity stakes. All of Fuji's major wholesalers are basically single-brand distributors, though they will occasionally sell other brands upon customer request. Konica sells through its affiliate, Konica Medical. As to the other major suppliers, Agfa's and DuPont's major wholesalers carry primarily the Agfa and DuPont brands. There is thus no significant sharing of distributors among the major producers.

5.72 Japan also argues that Kodak has a very strong position in the Japanese motion picture film market. In negative film, Kodak has an approximately 70 percent share, and Fuji has the remaining 30 percent.¹⁴⁹ In positive film, the situation is basically reversed: Fuji has a 60 percent share, and Kodak has around 40 percent. Agfa rounds out the market as a marginal supplier. Kodak has achieved its success by selling directly to users; Fuji employs independent single-brand distributors. Agfa, meanwhile, uses a single-brand wholesaler. Thus, the market realities for other film products are sharply at odds with the US theory of a distribution bottleneck in consumer film.

5.73 The **United States** explains that the US complaint specifically excludes various specialized films used by professional photographers for resale and various other specialty films (x-film, microfilm).

4. THE RESTRUCTURING OF THE JAPANESE FILM DISTRIBUTION SECTOR**(a) The origin of MITI's distribution policies in the early 1960s**

5.74 According to **Japan**, MITI had many reasons to be encouraging greater efficiency in the distribution system during the 1960's and 1970's. The concern with distribution modernization arose initially from the productivity lag of the Japanese distribution sector relative to other sectors of the Japanese economy, and the implications of this inefficiency. Historically, the distribution sector in Japan was characterized by small "mom and pop" enterprises and traditional, personalized business practices. The service sector was viewed largely as a place to employ those people who could not find employment in the manufacturing sector.¹⁵⁰ Accordingly, while Japanese manufacturers had recorded great successes in recent years, the distribution sector lagged behind in productivity and competitiveness. In Japan's view, the United States thus completely mischaracterizes the origin of MITI distribution policies. The objective was not helping Japanese manufacturers, as the United States claims. Rather, the foundation was coping with distribution inefficiency itself, and the interrelated problems of inflation and labour shortages.

5.75 The **United States** argues that the transformation of the open and competitive distribution system of the early 1960's into the vertically-integrated, domestic manufacturer dominated system was not accidental. It was the result of the direct intervention in the market by the Government of Japan. The Government of Japan discerned that reorganizing distribution along vertically-integrated lines would protect domestic manufacturers from foreign competition after liberalization. The United States alleges that MITI was the nerve center for formulating and implementing distribution countermeasures policy.

¹⁴⁸Affidavit of Tanaka Takeshi, p. 5, Japan Ex. A-10.

¹⁴⁹Ibid.

¹⁵⁰See, Fumitake Kishida, The Direction of Commercial Structure Improvement in The New Development Of Distribution Policy, International Trade and Industry Study No. 142 (December 1966), p. 32, Japan Ex. B-8; see also, Shintaro Hayashi, Thinking and Dealing with Distribution Issues in The New Development of Distribution Policy, International Trade and Industry Study No. 142 (December 1966), p. 4, Japan Ex. B-9.

To this end MITI formed a Distribution Committee that published 12 "interim reports" from 1964-1977, covering every aspect of the distribution system. Each interim report reflected a progressively deeper recognition of the inefficiencies of the Japanese distribution system, its vulnerabilities to foreign investment, and the impact that foreign penetration of the distribution system would have on Japanese manufacturers.

5.76 According to the United States, the First Interim Report identified a central theme that would underlie MITI's distribution policy: the need to limit competition in distribution in order to create stability and high prices for the benefit of domestic manufacturers.¹⁵¹ The Report described the Japanese distribution system as "extremely fractionalized" and characterized by "excess" competition, weak financial conditions, and inadequate management capability. The Report noted a trend toward vertical integration of distributors under the control of manufacturers, and observed that where there was vertical integration, it had improved the distribution structure and served to "secure and expand the [market] share of individual manufacturers."¹⁵² Later reports and government policies would continue to stress the benefits to domestic manufacturers of vertical alignment of distribution.

5.77 The United States further notes that the Third and Fifth Interim Reports¹⁵³ developed another theme that would become important for reorganizing the distribution system: horizontal business cooperation. The Third Interim Report specifically advocated providing financing and tax incentives for retailers to strengthen their ties with each other and with wholesalers through the development of joint physical distribution facilities.¹⁵⁴ The Fifth Interim Report advocated greater horizontal cooperation among wholesalers and retailers through the formation of, for example, joint wholesale centres, as well as greater vertical cooperation between manufacturers, the wholesalers, and retailers.

5.78 The United States argues that the Second and Fifth Interim Reports sowed still another seed that would become instrumental in reorganizing distribution: revising transaction practices between manufacturers and wholesalers in a way that would facilitate "rational" business relations between manufacturers and wholesalers.¹⁵⁵ Such "rational" transaction terms became a means to encourage the alignment of distributors into exclusive, long-term relationships with a single domestic manufacturer and a means to help resist foreign penetration of the distribution sector.

5.79 The United States further argues that along with examining the distribution structure generally in the Distribution Committee, MITI worked closely with individual sectors to begin discussing their specific structural issues. In the photographic sector in 1963, MITI urged the four domestic photographic film and paper manufacturers to band together to discuss ways to meet foreign competition. In response, the companies formed the Natural Colour Photography Promotion Council (NCPPC). MITI officials, including the official responsible for the photosensitive materials sector, attended the Council's meetings, and MITI officials recommended specific policies to help the Council achieve its objectives. The primary focus of the NCPPC was on the steps the photosensitive materials sector needed to take to prepare to meet foreign competition, concentrating particularly on distribution and sales network.

¹⁵¹Japan disagrees with this US interpretation of the First Interim Report. See translation issue 2.

¹⁵²Industrial Structure Council Distribution Committee, Current Status and Problems of Distribution Mechanisms (First Interim Report), December 1964, reprinted in Tsubansho Koho, 8 January 1965. Japan disagrees with the US translation of *keiretsuka* in the US translation of the First Interim Report, US Ex. 64-6. See translation issue 4.

¹⁵³Industrial Structure Council Distribution Committee, Concerning Improvement in Material Distribution (Fifth Interim Report), 19 October 1966, US Ex. 66-3.

¹⁵⁴Industrial Structure Council Distribution Committee, The Promotion of Chain Stores - Industrial Structure Council (Third Interim Report), reprinted in Tsusansho Koho, 14 September 1965, US Ex. 65-4.

¹⁵⁵Industrial Structure Council Distribution Committee, The Basic Direction of Policies on Distribution (Second Interim Report), reprinted in Tsusansho Koho, 24 April 1965. Japan disagrees with the translation of *keiretsuka* in the US translation of the Second Interim Report, US Ex. 65-2. See translation issue 4. Fifth Interim Report, US Ex. 66-3.

5.80 **Japan** admits that modernization of the distribution system has been an ongoing concern of the Government for more than three decades, including the periods both before and after the debate over capital liberalization. It notes, however, that the interim reports of the Distribution Committee are not official statements of the Government of Japan, and their issuance does not constitute "administrative guidance." Like the United States and other countries, the Government of Japan frequently organizes advisory bodies with members drawn from industry, academia, consumers, and the media, and charges them to study issues of public concern and issue recommendations for the Ministers.

5.81 Japan argues, however, that the aim of MITI's distribution policies was not to block imports but to modernize the Japanese distribution industry and help it to meet the foreign competitive challenge that would be unleashed by liberalization. Nothing in MITI's distribution policies or any other so-called "liberalization countermeasures" did anything to encourage or facilitate the creation of an exclusionary market structure that discriminates against imported film or paper. Japan's position is that since the MITI policies in question actually say nothing about encouraging single-brand distribution of film, the United States struggles to establish some connection between MITI's policies and the market structure that is the main target of its complaints. When confronted with the actual facts of this market, however, the United States' arguments about "distribution countermeasures" collapse.

5.82 Japan further argues that, in the end, the US claim boils down to an assertion that the current Japanese market structure for consumer photographic film and paper is exclusionary and closed, and that this abnormal situation must somehow be the result of government intervention. In Japan's view, the fundamental premise of this argument - that there is something abnormal about the distribution of film and paper in Japan - is simply wrong. At the root of the United States' complaints, Japan argues, is the fact that the various primary wholesalers in Japan each carry only a single brand of film. However, single-brand wholesale distribution is a normal business practice. In fact for film, this business practice is the norm in every major market in the world, including the United States. Consequently, the Japanese market for consumer photographic film and paper reflects the outcome of normal market forces.

5.83 Japan recalls the US argument that MITI's distribution policies during the 1960's and 1970's, i.e., the so-called "systemization" policies, formed the centrepiece of its alleged strategy to block imports of consumer photographic film and paper and to assist Japanese film manufacturers in gaining exclusive control over the "traditional" distribution channels for film, leaving imports without access to those channels. Japan argues that the US theory has nothing to do with the actual record of MITI's past or present distribution policies. MITI's policies sought more generally to rationalize and systemize Japan's wholesaling and retailing sectors, which were beset by low productivity. In particular, MITI encouraged the elimination of traditional outmoded business practices, the adoption of standardized forms and procedures, and the increased use of computer technology. Drawing on models from Western business practice, those business reforms were recommended across the board throughout the distribution sector, and were by no means specific to photographic film and paper.

5.84 The **United States** responds that contrary to Japan's assertions, the contents of the interim reports were implemented as administrative guidance. The United States recalls that in many instances, the Government of Japan directs the quasi-governmental policy entities such as the Distribution Committee of the Industrial Structure Council to undertake an investigation or survey, and the entity in response would complete that task and return a report to the Japanese Government. That report in turn is adopted, affirmed, or utilized by the Japanese Government as administrative guidance to direct the industry to alter its behaviour, thereby converting the "report" to measures.

5.85 The United States also contends that single-brand wholesaling of film is not common worldwide. Most photospecialty wholesalers in Europe and North America carry multiple brands of film as well as a wide range of other photographic products. Japan is confusing "single brand distribution" by

wholesalers with the common practices in Europe and North America of "direct-to-retail" sales by manufacturers.

5.86 In the US view, Japan's argument that its objective was only to modernize distribution channels, not block foreign entry, is undercut by its own submission to the Panel, which suggests that it held off foreign investment in the distribution sector in order to ensure that foreign manufacturers could not establish their own distribution networks in Japan until Japanese manufacturers had restructured their own distribution networks and made them more efficient. Moreover, if Japan intended only to promote distribution efficiency and not protect domestic manufacturers, it should have welcomed foreign investment in the distribution sector, because foreign distributors were four to seven times more efficient than domestic distributors.

(b) The 1967 Cabinet Decision

5.87 The United States notes that in 1966, MITI completed a survey that examined various problems domestic industries were likely to face because of liberalization. MITI identified Kodak and Agfa as foreign companies that were likely to enter the Japanese market for camera and photosensitive materials after capital liberalization. As a result of its survey, the United States asserts that MITI issued a policy statement on 17 April 1967, indicating that "liberalization countermeasures" were needed to defend the domestic firms from competition.¹⁵⁶

5.88 The United States asserts that the 1967 Cabinet Decision was a watershed in the Government of Japan's efforts to restructure Japanese industry to resist imminent foreign competition.¹⁵⁷ This Decision formally endorsed the use of countermeasures to offset the effects of liberalization, making the protection of Japanese markets from foreign a competition a high national priority. The Decision emphasized that the distribution sector was a key area for renovation and improvement to support the production sector, using the concerted industry-government approach:

"Modernization lags behind most in the distribution sector. Here the power of resistance against the inroad of foreign capital is weak, and the impact of foreign capital advancing into this sector will also pose significant impact on the production sector. It is necessary, therefore, to implement countermeasures in support of the efforts of industry with the objectives of modernizing the distribution structure, fundamentally strengthening the enterprises in this sector, and establishing a mass sales system."¹⁵⁸

The United States argues that the language of the Cabinet Decision established a clear national priority to pursue distribution policies aimed at protecting domestic manufacturers from foreign competition.

5.89 **Japan** counters that as it began to dismantle trade and investment barriers in the 1960's, it was concerned generally about the ability of domestic industries to compete with foreign rivals in the new, less regulated business environment. The Cabinet Decision, which implemented the first stage of capital liberalization, was quite direct in expressing this concern. The United States, however, quotes selectively from this document to create a distorted impression of the Cabinet Decision. Contrary to US arguments, Japan sought to promote the efficiency and competitiveness of domestic industries, not block imports. In urging modernization of the distribution sector in anticipation of capital liberalization, the Cabinet Decision was simply applying to one sector a basic general policy for coping with liberalization:

¹⁵⁶MITI, Regarding Capital Liberalization, 17 April 1967, reprinted in Yoshido Fujio, Capital Liberalization and Foreign Investment Law, 30 October 1967, US Ex. 67-3.

¹⁵⁷US Ex. 67-6.

¹⁵⁸1967 Cabinet Decision, p. 6, US Ex. 67-6.

"to guide and complement efforts by the private sector for example, bolstering future technological development, increasing owned capital and lowering interest rates, especially long-term interest rates, in order to create the basis on which our enterprises can compete against foreign capital on equal terms."¹⁵⁹

Japan argues that distribution modernization, which initially served to promote efficiency and to cope with inflationary pressures would also help the Japanese distribution sector compete with foreign capital. The purpose was to secure effective competition in the domestic market through improving the efficiency of the domestic distribution sector.

5.90 According to Japan, the sweeping US assertion about a "clear national priority" of achieving protection from foreign competition has no support in the text of the Cabinet Decision. The Cabinet Decision notes only that foreign capital in the distribution sector will have a "significant impact" on the manufacturing sector, but that statement simply recognizes the obvious relationship between distribution and manufacturing in the economy, which would be affected by capital liberalization.¹⁶⁰ Japan argues that so long as foreign producers were competing in Japan by exporting, the backwardness of the distribution system was not a problem. Tariff reductions might make imported products more price-competitive, but they would provide no other marketing advantage. On the other hand, once foreign producers were allowed to establish their own sales subsidiaries in Japan, the relative backwardness of the distribution systems upon which the domestic producers had been relying would become a potentially acute disadvantage.

5.91 In Japan's view, there is no discussion in the Cabinet Decision of protecting domestic manufacturers from foreign competition at all, let alone a discussion of using distribution policies to protect manufacturing companies. The Cabinet Decision refers only to ways in which the government can help Japanese companies -- in both the distribution and manufacturing sectors -- prepare for the intensified competition that capital liberalization will bring.

(c) The 1968 Sixth Interim Report

5.92 The **United States** argues that it was the Distribution Committee that was charged with the task of determining how to convert the Cabinet's general decision into specific policies. The Distribution Committee came up with a policy to achieve the twin goals of enhancing efficiency and protecting against foreign competition - "systemization" of distribution.¹⁶¹ The premise of distribution systemization was that even though foreign investment in distribution might enhance efficiency in the distribution sector, it would threaten Japanese manufacturers. The Sixth Interim Report analyzed ways that foreign manufacturers might gain control of Japan's distribution system,¹⁶² and highlighted the concerns of such control:

1. There is a risk that growth sectors will fall under the monopolistic control of foreign capital, resulting from the difference in capital resources and the like.

2. There is a risk that the process of sales expansion by foreign capital affiliated distribution enterprises will aggravate excessive competition and hinder the smooth implementation of distribution modernization plans, and the [established] order of trade will be disrupted.

¹⁵⁹Ibid., p. 4, US Ex. 67-6.

¹⁶⁰Ibid., p. 6, US Ex. 67-6.

¹⁶¹Japan notes that MITI distinguishes rationalization and systemization policies. The United States uses the single term, "systemization" to cover both concepts.

¹⁶²Sixth Interim Report, p. 6, US Ex. 68-8.

3. There is a risk that the manufacturing sector will be dominated by controlling the sales routes, bringing about the international subcontracting of Japanese industry."¹⁶³

5.93 According to **Japan**, in light of the 1967 Cabinet Decision, MITI and the various advisory committees renewed their focus on distribution modernization. The Sixth Interim Report indicated:

"Today, the delay in modernizing distribution activities is often seen to prevent the effectiveness of economy and improvement of people's living. The necessity of improving the structure of the distribution industry is gradually increasing. In addition, the modernization of distribution activities is pressed by the following two viewpoints. First, liberalization of direct investment by foreign capital is drawing near. It is necessary to quickly establish [market] conditions in which domestic capital could compete with foreign capital. Second, improving productivity of distribution activities is considered an effective way to solve the consumer price issue."¹⁶⁴

5.94 Japan further argues that the basic need for distribution modernization arose from the need for efficiency to improve the standard of living. A further rationale for distribution modernization continued to be concern about inflation. Coping with capital liberalization was added to these other rationales, but the report is clear in stating that coping meant competing more effectively with the new foreign entrants. This goal was to be achieved by promoting efficiency in the distribution sector.

5.95 In Japan's view, the US claims are untenable. MITI hardly regarded the existing distribution system as some sort of strategic "crown jewels" that imports must not be allowed to use. On the contrary, MITI saw the backwardness of the distribution system as an "Achilles' heel" that would render domestic manufacturers unable to compete with foreign producers. The concern was that domestic manufacturers would be stuck with existing distribution channels while foreign producers, freed from capital restrictions, would be able to construct their own modern (and exclusive) distribution channels. Japan cites the 1968 Sixth Interim Report which stated:

"In the case of penetration for the purpose of selling the foreign manufacturers' own brand of products ... (including cases in which foreigner producers actually control distribution), when the goods are superior, [the manufacturer] has highly developed sales techniques or large marketing funds, there probably will be a considerable impact on rival Japanese producers and the businesses that serve as distribution channels for domestic products."¹⁶⁵

5.96 Japan's position is that while foreign producers would be able to choose between using existing Japanese distribution channels or importing their own systems, Japanese producers would have to sink or swim with their domestic distributors. Consequently, the purpose of MITI's distribution policies was to encourage the modernization of Japanese distribution practices, and thereby serve various policy goals including improving the competitiveness of Japanese industry.

(d) The 1969 Seventh Interim Report and the Distribution Systemization Promotion Council

5.97 The **United States** argues that the Japanese preoccupation with protection is further evidenced by the Seventh Interim Report of the Distribution Committee¹⁶⁶, which it asserts states that to the extent

¹⁶³Ibid., p. 8.

¹⁶⁴Sixth Interim Report, Japan Ex. B-7.

¹⁶⁵Ibid., p. 22.

¹⁶⁶Industrial Structure Council Distribution Committee, Systemization of Distribution Activities (Seventh Interim Report), 22 July 1969, p. 6, US Ex. 69-4.

that fostering efficiency became inconsistent with protection against foreign competition, the latter goal should prevail. The relevant language in the Seventh Interim Report reads:

"Today, amidst calls for the active promotion of capital liberalization in the distribution sector, we think that efforts to systemize distribution have a vital importance in strategic significance. ... [T]he systems gap [between Japan and America] is expected to have a decisive effect on distribution activities in particular, the concerted efforts of the government and the private sector must be directed at systemization from the point of view of a capital liberalization countermeasure.

[I]t is true that one effect of systemizing Japan's distribution system is the simplification of entry [into Japan's market] by foreign capital, [enterprises] which are more adept at systems methodology. [But] to make inroads, we should instead emphasize preventing the immense impact that would be felt if foreign capital took the lead in systemizing Japan's distribution activities, and quickly develop a system sufficiently capable of countering the rational systems introduced by foreign capital."¹⁶⁷

5.98 The United States further argues that the premise of distribution systemization was to reorganize the Japanese distribution system along vertical and horizontal lines by -

- (i) the formation and strengthening of product-specific vertical distribution ties between a Japanese manufacturer and various wholesalers, and between these wholesalers and retailers;
- (ii) the creation of linkages among horizontal elements of the distribution system, which could be brought more easily into the "systemized" vertical arrangement.

5.99 According to the United States, under the Government of Japan's systemization plan, the nature of the links between companies in a "system" would include commercial transaction ties, physical ties, and informational ties. Each of these ties would become essential to ensuring that the system operated as a single and exclusive whole. Horizontal business cooperation among small retailers and other small scale entities in the distribution system would be "the most efficient way to realize profit from economies of scale."¹⁶⁸ Horizontal cooperation also would make the system more difficult for foreign firms to penetrate because many of the individual actors in the system would be bound together in a common distribution channel tied to and dominated by domestic manufacturers.

5.100 **Japan** responds that the Seventh Interim Report¹⁶⁹ outlined the basic direction of desirable systemization in all aspects of distribution, from management planning to business transactions to managing merchandise to finance:

- (i) **Management Planning:** the report encouraged the use of computers to track sales trends to share information with suppliers and customers.
- (ii) **Business Transactions:** the report encouraged the automation of materials handling, scheduled deliveries along set routes, and the establishment of distribution centers for joint use.

¹⁶⁷Seventh Interim Report, p. 4, US Ex. 69-4.

¹⁶⁸Sixth Interim Report, p. 11, US Ex. 68-8.

¹⁶⁹Seventh Interim Report, US Ex. 69-4.

- (iii) Managing Merchandise: the report encouraged the use of computers to maintain inventory at appropriate levels, the taking of orders by telephone using order books, and the use of automated ordering systems.
- (iv) Finance: the report encouraged the use of computers to manage accounts receivable and accounts payable, automated invoicing and bank settlements, and computerized credit research.

5.101 The **United States** points to a recent book on distribution by a Japanese academic that summarized the objectives of the Japanese government's distribution systemization policies as liberalization approached. Commenting specifically on the Seventh Interim Report, he wrote that its basic purpose was to create vertically integrated systems:

"Its intent was to build a huge pipe connecting production with consumption and to improve the effectiveness and efficiency of distribution by achieving effectiveness and efficiency in vertical operations. ... [T]he distribution systemization ultimately encouraged vertical integration of distribution and caused giant enterprises' control over distribution to become even stronger."¹⁷⁰

He emphasized that the Seventh Interim Report represented a transformation in the Government's policy from merely improving efficiency to ensuring manufacturer control of the market:

"We must keep in mind that [Japan's] national distribution policy, aimed at building a mass distribution system sought by giant enterprises to be compatible with a mass production system, had been transformed into a reinforcement of marketing activities by giant enterprises whose goals were to control distribution and the market This characteristic of the distribution policy was further strengthened by the promotion of distribution systemization policy."¹⁷¹

Another Japanese academic expert, writing in 1974, also characterized the MITI-led distribution reforms of the period as aiming at excluding foreign companies:

"[T]he major reasons why this type of distribution systemization has been particularly emphasized during the Showa 40's [1965-1974], especially the latter part of Showa 40's, [1970-1974] are because of the following:

... while coping with capital liberalization and pushing forward the delayed rationalization of Japan's distribution industry, at the same time, the nation as one [will] build barriers to entry into the distribution system; which leave no margin for foreign companies to penetrate Japan's economy."¹⁷²

5.102 The United States argues that the Seventh Interim Report called for joint government-industry cooperation to implement systemization, along with tax and financial incentives for projects that would promote systemization. To foster coordination between government and industry, the Report proposed the formation of another government-industry body, the Distribution Systemization Promotion Council, to promote and build consensus for systemization. The Report also cited the need for research and guidance for specific industries to carry out systemization according to their specific needs and circumstances.

¹⁷⁰Sasaki Yasuyuki, Distribution Policies in Japan and the West, 16 June 1995, US Ex. 95-12.

¹⁷¹Ibid.

¹⁷²Shirahige Takeshi, Chapter 1, Development of Distribution Policies, Current Distribution Issues in Modern Japan [Gendai Nihon no Ryutsu], Ooya Junichiro (Publisher), Tokyo, 26 February 1974, p. 9, US Ex. 74-1.

5.103 The United States indicates that MITI formed the Distribution Systemization Promotion Council in 1970. The head of the Council described its efforts as uniting government and the private sector in a common purpose:

"The Distribution Systemization Promotion Council was established ... as a forum for promoting the systemization of distribution through the joint efforts of government and the private sector. ... [O]ver a period of ten months, over 100 people from industry, academia and government have worked literally as one united body."¹⁷³

(e) The 1971 Basic Plan

5.104 The United States further indicates that in 1971, the Council published its "Basic Plan for Distribution Systemization." Upon its publication, the chief of MITI's Business Bureau stated that the Plan was "urgent from the standpoint of ... capital liberalization countermeasures," and that "[w]ith this plan, the Ministry of International Trade and Industry has decided to make every effort toward the fulfilment of distribution systemization policies."¹⁷⁴ The United States further indicates that the plan's authors expressed the intention that "government and private sector, working as one, will pursue concrete implementation [from now] until 1975, based on this policy"¹⁷⁵ and reiterated the view of systemization as vertical and horizontal integration:

"The decisive approach here is to regard the entire process of distribution from production to consumption as a single system. ... In particular, such systemization of distribution must be realized through various stages: vertically from the intra-firm level to the inter-firm level, horizontally on the inter-firm level to the national economic level" ¹⁷⁶

5.105 The United States notes that in dividing responsibility between government and industry for implementing systemization, the Plan stated that the manufacturers should assume primary responsibility for accomplishing vertical integration, with "positive support and guidance" from the government. In the area of horizontal cooperation, the government would "take positive action."¹⁷⁷

5.106 **Japan** asserts that the 1971 Systemization report also determined that broad-based standardization was necessary for such goals to be achieved. Specifically, the report encouraged standardization of merchandise and trade codes, of invoice forms and accounting records, and of shipping containers. According to Japan, none of these ideas were particularly novel. Indeed, Japanese academics introduced ideas of systemization borrowed from the west, and the various interim reports noted the fact that foreign companies were already aggressively pursuing systemization to improve efficiency.

(f) Vertical integration

5.107 The **United States** argues that Japan's intent to promote vertical keiretsu in its systemization policy comes out clearly in the Seventh Interim Report¹⁷⁸, as well as in the Basic Plan for the

¹⁷³Distribution Systemization Promotion Council, The Basic Plan for Distribution Systemization, 28 July 1971, p. 3, US Ex. 71-10. Japan disagrees with the translation of *keiretsuka* in the US translation of the 1971 Basic Plan, Japan Ex. B-18.

¹⁷⁴Ibid., Introduction, US Ex. 71-10.

¹⁷⁵Ibid., Preface.

¹⁷⁶Ibid., Foreword.

¹⁷⁷Ibid., p. 9.

¹⁷⁸Seventh Interim Report, p. 7, US Ex. 69-4.

Systemization of Distribution¹⁷⁹ in which it allegedly admitted the need to regard the entire process of distribution from production to consumption as a single system.

5.108 With respect to the US argument that both the rationalization policies and the systemization policies were intended to encourage vertical integration, **Japan** contends that the United States is compelled to make this argument because otherwise the actual terms of the various distribution policies are completely unexceptional, and have nothing to do with the US theory about a government-created "distribution bottleneck." According to Japan, vertical integration is the missing link in the US "bottleneck" theory.

5.109 In Japan's view, the US attempt to develop a logical link between MITI distribution policies and incentives to vertically integrate stems from a simple reason - the documents themselves do not talk directly about any intent to encourage vertical integration. According to Japan, there are no statements - either by MITI or by the various advisory councils - directly calling for vertical integration. To the contrary, to the extent there is any discussion of vertical integration at all, one finds in the various advisory council reports ambivalence at best and often hostility towards excessive vertical integration.

5.110 Japan contends that as mass manufacturing had emerged in Japan more swiftly than mass distribution, some manufacturers were integrating forward into distribution to facilitate the marketing of their products. Although this process may have been economically rational for manufacturing, those studying the distribution sector regarded it with concern. Japan concludes that this ambivalence about vertical integration goes back to the very beginning of systematic thinking about distribution policies. This explicit concern about the problem of vertical integration into distribution started before the debate over capital liberalization and continued after the debate began. As an example, Japan cites the Sixth Interim Report in 1968, which saw vertical integration as a problem.¹⁸⁰

(g) Single-brand distribution

5.111 Japan suggests that in effect the United States is asking the Panel to infer government involvement in the Japanese photographic materials market because the market structure in this sector is so abnormal that it could not possibly be the result of private business decisions and market forces. However, according to Japan, single-brand distribution occurred as an industry trend before the alleged measures were implemented. Single-brand wholesale distribution is a common business practice and its advantages are quite familiar to economists and business people. Likewise, affiliations between photographic materials manufacturers and photofinishing laboratories also prevail worldwide. The consistent prevalence of these market structures around the world is due to market factors, not government measures. Japan argues that there are strong economic incentives that lead to vertical integration in this industry.

5.112 According to Japan, the economic efficiencies of integrating manufacturing and distribution - whether through outright ownership or contractual relationships - are well known. Integration is said to facilitate greater flexibility in responding to changing market conditions; it reduces incentives for opportunistic behaviour between manufacturer and distributor; it allows for better information flows through the distribution pipeline; and it generally ensures greater focus and effort on behalf of the manufacturer's brand. In Japan's view, it was a recognition of these advantages that led to the strong criticism of Kodak's long delay in establishing directly controlled distributors in the Japanese market. Therefore, there was simply no causal connection between MITI's systemization policies and the decisions by the primary wholesalers about which film brands to carry. Japan asserts that, there is nothing at all unusual about the Japanese market structures for film and paper. Single-brand wholesale distribution is a common business practice. According to Japan, single-brand wholesale distribution of film prevails

¹⁷⁹1971 Basic Plan, p. 6, US Ex. 71-10.

¹⁸⁰Sixth Interim Report, p. 10-11, Japan Ex. B-7.

in every major market in the world. Likewise, affiliations between photosensitive materials manufacturers and photofinishing laboratories prevail worldwide. Thus, concludes Japan, the consistent prevalence of these market structures around the world is due to market factors, not government measures.

5.113 Japan further shows that in the Japanese market, vertical integration by manufacturers into distribution resulted naturally from the fact that the production sector developed and modernized faster than the distribution sector. In light of this, it was a natural reaction by manufacturers to integrate forward into distribution to apply their superior resources to marketing their products.

5.114 Consequently, Japan is of the view that decisions by Fuji's wholesalers to become single-brand film distributors occurred in the context of a larger industry trend towards single-brand wholesale distribution. This trend was guided by market forces not government policy. Japan asserts that the United States tries to avoid this unavoidable conclusion by elevating deliberations of the Industrial Structure Council's Distribution Committee to the level of Japanese Government policy. In reality, Japan maintains that the United States had nothing to link actions taken by Fuji and Konica, regarding either single-brand distribution or transaction terms, to government action.

5.115 According to Japan, the US interpretation of events is at odds with the timing of Fujifilm's and Konica's evolving relationships with their primary wholesalers. Of the four major primary wholesalers that currently are single brand Fujifilm wholesalers, two of them, i.e., Kashimura and Ohmiya, have never carried Kodak film products since World War II. Both once carried Konica products; Kashimura terminated that relationship in 1963, and Ohmiya did the same the following year. Thus, these two distributors have been single-brand Fujifilm wholesalers for over three decades -- well before capital liberalization even began, and before MITI began to formulate and articulate its distribution modernization policies.

5.116 Japan notes that a third primary wholesaler, Misuzu, carried multiple brands, including Fujifilm, Kodak, Konica, Agfa, and the English brand Ilford, until 1968, when it became a single-brand Fujifilm distributor and withdrew from all other film brands. Actually, Misuzu terminated dealings with Kodak in April 1967, even earlier than its final decision to become a single-brand distributor. Here again, the move to single-brand wholesale distribution occurred before MITI issued its 1970 Guidelines for film and the termination of Kodak preceded both the 1967 Cabinet Decision and the 1970 Guidelines.

5.117 Japan further notes that only one of the major primary wholesalers, Asanuma, made the decision to carry only Fuji brand film after MITI's distribution policies had been developed and articulated. In 1973, Asanuma travelled to Rochester, New York to meet with top Kodak officials. Asanuma, which prior to 1960 had imported directly from Kodak, requested a resumption of direct dealings. Kodak refused, saying that it was satisfied with the job being done by Nagase, its exclusive importer and primary wholesaler.¹⁸¹ If Asanuma wanted to carry Kodak film, it would have to continue to go through Nagase.¹⁸² Two years later, Asanuma gave up on a product line in which it was forced to buy from a competing distributor, and announced that it would carry only Fuji brand film.¹⁸³ Government measures played no role in pressuring Asanuma into dropping Kodak. Japan argues that the US claims about the alleged effects of governmental policies are simply not credible.

5.118 According to Japan, even Kodak has built highly effective single-brand distribution networks all over the world. Japan argues that Kodak's marketing strategy in Japan during the 1960's and 1970's

¹⁸¹Japan notes that the United States provided affidavits from Albert Sieg and William Jack to respond to this inconvenient history. Japan argues that a close reading of the affidavits, however, reveals that neither person denies the claims made by Asanuma. See US Ex. 97-1 and US Ex. 97-2.

¹⁸²Affidavit of Takenosuke Katsuoka, p. 2-4, Japan Ex. A-11.

¹⁸³According to Japan, although Asanuma does not carry Kodak film, it does carry Kodak slide projectors, CCD cameras and digital lab tools. See Affidavit of Takenosuke Katsuoka, p. 4, Japan Ex. A-11.

became increasingly oriented toward single-brand wholesale distribution. Prior to 1960, Kodak exported directly to several Japanese importers, including Asanuma. In 1960, however, Kodak made Nagase its exclusive importer. Nagase then resold film to multibrand wholesalers, who in turn distributed Kodak products directly to both retailers and through secondary wholesalers. Japan also alleges that in the 1960's Nagase began to build up its own direct distribution capacity through acquisition. Thus, according to Japan, Kodak based its marketing strategy in Japan during the 1960's and 1970's on its exclusive relationship with Nagase. Nagase in turn began to acquire primary wholesalers to develop its own single-brand wholesale distribution system for Kodak products.

5.119 Japan alleges that Kodak's exclusive reliance on Nagase and its single-brand wholesale distribution network continued in the 1980's, when Kodak after long delay decided to increase its commitment to the Japanese market. In 1986, Nagase's Kodak products division was spun off into a 50-50 joint venture between Kodak and Nagase. A few years later Kodak increased its stake to 70 percent, and in 1996 finally bought out Nagase's remaining interest. In fact, Japan argues that Kodak is more vertically integrated into distribution than Fuji, in the sense that Kodak owns its primary wholesaler.

5.120 The **United States** argues that the Japanese film and photographic paper market is not identical to other markets around the world, but is completely unique. Nowhere else has the government engineered the distribution system to thwart foreign competitors. In addition, the United States disputes Japan's assertion that single-brand wholesale distribution of film "prevails in every major market in the world." In fact, most wholesalers in North America and Europe carry multiple film brands. Japan appears to be confusing manufacturers' "direct-to-retail" film distribution, which is common outside Japan, with Japanese wholesalers' exclusive dealing relationships with the domestic manufacturers. Prior to 1960, Kodak exported directly to several Japanese importers, including Asanuma, but in 1960 it made Nagase its exclusive importer. This action was undertaken not as a strategic decision but because in 1960, at the request of the Japanese Government, Kodak was required to select one import firm as its sole import agent, thus facilitating the implementation of Japan's quantitative import restrictions.¹⁸⁴ Kodak Japan, a wholly-owned subsidiary of Eastman Kodak, is not a wholesaler. It distributes directly to Japanese retailers because of its inability to gain access to the main Japanese distribution channels for photographic products.

5.121 The United States notes that the European Communities also disputes Japan's position with respect to single-brand distribution. It states that it is standard practice all over the world for photographic producers to have one subsidiary per country representing their interests in selling their products to wholesalers, retailers, dealers or consumers. The extraordinary situation in Japan, which has no known parallel anywhere else, is the existence of four tokuyakuten distributing exclusively the same products of only one company, the major domestic producer. A subsidiary of a European company in Japan is in the same situation as the Japanese producers themselves. It must find means to enter the market, which includes the four tokuyakuten, already serving the large majority of retailers. As long as these four refuse to purchase any film other than that produced by Fuji, market access for imported film will be impaired.

5. THE STANDARDIZATION OF TRANSACTION TERMS

(a) Introduction

5.122 In the view of the United States, the implementation of rational transaction terms was a central focus of the plan towards vertical integration. The transaction terms requiring rationalization included such terms as discounts, rebates, delivery conditions, price, and dispatched employees. The rationalization of transaction terms was designed to -

¹⁸⁴Ueno Akira, *The Story of Kodak (Kodakku Monogatari)*, 1989, p. 152, US Ex. 89-2, and Affidavit of Albert Sieg, US Ex. 97-1.

- (i) foster the commercial alignment of wholesalers with a particular domestic manufacturer, and of retailers with a particular wholesaler;
- (ii) limit the ability of foreign firms to use their competitive strength to attract distributors away from domestic suppliers.

5.123 The United States argues that to this end MITI established the Transaction Terms Standardization Committee to determine on a sector-by-sector basis, the transaction terms among manufacturers and distributors that were needed to "systemize" distribution and prevent foreign penetration of the market. The committee specifically called for the use of cumulative rebates and tightened payment terms, which would make retailers more dependent on domestic manufacturers, to the exclusion of foreign enterprises:

"The standards for standardizing transaction terms considered desirable by MITI are as follows:

- 2) In order to promote high-volume sales, volume discounts and cash discounts should be given. In addition, rebates should be progressive rebates.
- 3) To reduce finance costs, the following principles should be applied: 5 percent discount for cash settlement, no discount provided if paid with 60-day notes, and appropriate interest charged for notes over 60-days."¹⁸⁵

5.124 The United States notes that the Transaction Terms Standardization Committee correctly recognized that these transaction terms would tend to exclude foreign companies in industries like film and photographic paper where domestic firms already enjoyed dominant market shares and foreign firms' access was strictly limited by tariffs and quotas. Using volume discounts and cumulative rebates would promote systemization by encouraging exclusive relationships between a manufacturer and its distributors and retailers. Volume discounts and cumulative rebates reduce the average price of a manufacturer's product to the distributor if the distributor purchases a certain quantity of that product. These savings encourage the distributor to purchase as much of that product as possible from a single manufacturer. The same holds true with respect to rebates from the wholesaler to the retailer.

5.125 According to the United States, a government-coordinated effort to shorten the payment terms would successfully shift the financing burden from manufacturers to distributors or retailers. Wholesalers throughout the film sector typically carried large cash balances and paid for their goods over extended periods. Therefore, shortening payment terms meant that wholesalers would no longer benefit from what amounted to easy credit from the manufacturers, a change that would substantially erode their bottom lines and, by weakening them, open them to greater control from the dominant domestic manufacturers. Among other things, in a weakened financial state, the wholesaler or retailer became more dependent upon obtaining the rebate to make the difference between profit and loss.

5.126 In the US view, prior to standardization, wholesalers were able to "shop around" different manufacturers for the best transaction terms, and extended credits were a common business practice. MITI reduced such competition in the distribution sector by limiting opportunities for the wholesalers to "shop around". The result was to offer stable, long-term relationships among the players in the distribution system.

5.127 **Japan** responds that, MITI has consistently been concerned with rationalization of trading terms in the distribution sector since the 1960's. In Japan's view, concerns in the late 1960's initiated a process of encouraging ongoing rationalization to improve the efficiency of the distribution sector. Japan points

¹⁸⁵Film Purchases from Manufacturers: Supermarket and Chain Store Trade Terms, Zenren Tsuho, November 1969, US Ex. 69-5.

out that although the initial efforts were in the 1960's and 1970's, this push for rationalization later received a new impetus in the 1990's as part of the United States-Japan Structural Impediments Initiative ("SII") talks.

5.128 In Japan's view, this concern with "irrational" traditional business practices goes back to at least 1965 and the Second Interim Report, more than two years prior to the 1967 Cabinet Decision announcing the first stage of capital liberalization. The common problem underlying these various traditional business practices is that they all interfere with the swift and transparent transmission of market information up and down the distribution chain. Thus, with long payment terms and liberal return policies, there need not be tight coordination between what a retailer is buying and what it is actually selling; a manufacturer might think it had sold 100 units, only to find at the end of a period that 25 units were being returned. Unclear discounts and rebates make it impossible for a retailer to know its true costs and whether particular retail prices are actually profitable.

5.129 According to Japan, the Sixth Interim Report concluded that such business practices are "economically irrational" and that they "harm the stability of enterprise management, increase[s] distribution cost, and lead to the shifting of the burden to consumers."¹⁸⁶ Accordingly, Japan argues, the report concluded that "it is necessary to establish standard transactions terms in the direction that will contribute to the improvement of distribution functions, and to strive for their widespread adoption."¹⁸⁷ By recommending the adoption of new standard practices to replace traditional terms of trade, the report sought to rationalize the distribution sector's coordination of supply and demand by improving information flows.

5.130 Japan notes that as a follow-up to the Sixth Interim Report, MITI commissioned surveys of the actual trading conditions in a number of different industries, including one on photographic film. These surveys, conducted by the Institute of Distribution Research, sought to understand how these general problems affected specific industries. The surveys examined business practices in the following areas: (1) sales contracts, including discount and rebate policies; (2) deliveries and returns; (3) settlement of accounts; and (4) promotional practices, including dispatched employees and rebates.

5.131 Japan argues that, having identified problems in various industrial sectors, MITI began the process of issuing guidelines to address these problems. Over the 1970 to 1972 period, MITI issued rationalization guidelines to 15 different industries that had been surveyed earlier: cotton and chemical textiles, stationery and paper products, glassware, umbrellas, rubber footwear, photographic film, instant coffee, household cleaners, small tools, publications, kimono fabrics, pharmaceuticals, knitted underwear, cameras, and ceramics. The guidelines issued by MITI to each of the 15 industries addressed the same issues and made basically the same suggestions.¹⁸⁸ According to Japan, for industry after industry,¹⁸⁹ MITI:

- (i) suggested greater use of cash discounts;
- (ii) suggested greater use of volume discounts;

¹⁸⁶Sixth Interim Report, p. 17, Japan Ex. B-7.

¹⁸⁷Ibid., p. 17.

¹⁸⁸Japan argues that these guidelines were offered to some industries for which import competition was irrelevant and was therefore not even mentioned in the underlying survey, such as kimono fabrics and publications. This fact, together with the similarity of the suggestions in the guidelines, confirms that the purpose of the rationalization guidelines -- for film as well as other guidelines -- was in fact modernization, not import protection.

¹⁸⁹Torihiki Jouken no Tekiseika Shishin (Guidelines for Rationalizing Terms of Trade), Tsusansho Kouhou, June 14, 1972, Section 2, pp. 11-30, Japan Ex. B-21.

- (iii) suggested the disclosure of the basis or conditions upon which cash and volume discounts were granted;
- (iv) suggested the use of rebates to be minimized;
- (v) suggested that the frequency of deliveries be reduced to improve efficiency;
- (vi) suggested the adoption of minimum orders;
- (vii) suggested that the merchandise be returned only if it was defective or damaged
- (viii) suggested that accounts be settled in full either by cash or by promissory note and that interest be charged on notes with exceedingly long periods;
- (ix) suggested the elimination of the practice of dispatching employees with the exception of when the sale of a product requires specialized knowledge.

In Japan's view, none of the measures above indicate any anti-foreign bias.

5.132 According to the **United States**, it was also a central focus of the 1971 Basic Plan to implement rational transaction terms in the distribution sector "in order to prevent disruption of the [established] order by foreign capital-affiliated firms, which have enormous capital strength."¹⁹⁰

5.133 **Japan** responds that the United States takes a single sentence from this report and then jumps to the conclusion that "a central focus" of the plan was to prevent foreign firms from disrupting the "order of trade." This sentence is but one of four reasons for rationalizing such traditional trade practices. More importantly, Japan notes that the United States takes this sentence out of proper context. This sentence refers back to the introductory paragraph of this section, which identifies traditional "irrational" practices. There is nothing at all improper about a concern that dominant firms -- whether they are domestic or foreign firms expected to enter the market -- not abuse their market power. The Foreword makes clear that the overall thrust of the report was:

"an urgent need to improve distribution functions in response to the shift toward an information society and a consumer-oriented economy, and also to save labour and improve productivity in response to the worsening labour shortages."¹⁹¹

For Japan, it is clear that the push for systemization served a number of policy objectives. In fact, the vast bulk of the report focuses on a broad range of issues completely unrelated to this quotation cited by the United States out of context.

(b) 1970 Guidelines

5.134 The **United States** argues that in 1970, the Japanese Government cemented its efforts on transaction terms by issuing the "Guidelines for Standardization of Transaction Terms for Photographic Film".¹⁹² The Guidelines strengthened the transaction terms, and the net effect was to shift the financial burden from wholesalers to retailers, making the latter vulnerable to control from dominant suppliers. The Guidelines noted potential concerns with rebates under the Antimonopoly Law but at the same time recognized their value. The Guidelines reiterated the call for toughened transaction terms. They noted that wholesalers generally had been repaying outstanding balances in full within 60 days (whereas

¹⁹⁰1971 Basic Plan, p. 10, US Ex. 71-10.

¹⁹¹1971 Basic Plan, p. 4, Japan Ex. B-18.

¹⁹²US Ex. 70-4.

previously payment terms had been 210 days), but that problems still existed with the retailers. Specifically, retailers continued to rely heavily on credit and enjoyed unusually long payment terms. The United States asserts that the Guidelines called for strict tightening of these terms, stating that accounts should be settled in full in cash or promissory notes with appropriate interest. This tightening of transaction terms amounted to again shifting the financial burden, this time from wholesalers onto retailers, making the latter vulnerable to control from dominant suppliers through such means as the use of rebates.

5.135 According to the United States, the domestic photographic industry understood that MITI viewed the use of rebates as a means to systemize distribution in the face of foreign competition. The United States points to an article on liberalization in a leading photo industry journal, which stated that "MITI's guidelines for standardizing transaction terms are what might be called an 'immunization'." The article noted that it was important to "clarify and rationalize transaction terms . . . out of concern that, as liberalization moves forward, the trading system would be disrupted." The article elaborated that "the Guidelines themselves may be described as an attempt to equalize the conditions of competition." For instance, rebates were adopted so that once they become common practice in the industry, "the influx of foreign capital may be checked by the application of the Antimonopoly Law."¹⁹³

5.136 **Japan** argues that the 1970 Guidelines were simply general suggestions and lacked any legal force. Japan maintains that the recommendations contained in the Guidelines were completely unremarkable. Significantly, Japan points out that the recommendations in the 1970 Guidelines did not in any way distinguish between imported and domestic products. Japan argues that there is nothing in the Guidelines that can be construed as encouraging the creation of an exclusionary market structure. Further, the relationship between manufacturers and wholesalers was not even the focus of the 1970 Guidelines. In Japan's view, the recommendations in the 1970 Guidelines concentrated on transaction terms between wholesalers and retailers.

5.137 In response to Japan's assertion that its only measure regarding transaction terms was the 1970 MITI Guidelines which in Japan's view were merely suggestions, the **United States** alleges that MITI made it clear that it expected that the photographic film industry would implement the Guidelines with veiled threats of possible legislative action if industry did not respond, along with the demand for industry to follow up with a report to MITI on progress on implementing the transaction terms. The United States notes that MITI published the final Guidelines in March 1970 in an industry journal and requested industry associations to formulate and implement more specific transaction terms based on the Guidelines. In response to MITI's demand, the photospecialty wholesalers association in November 1970 promptly published a "Transaction Outline" to implement the associations own transaction terms, and the association reported the outline to MITI.

5.138 The United States argues that the 1970 Guidelines were preceded and followed by a "near continuous series of measures", and the monitoring by MITI of the implementation of its Guidelines. This extended interaction between government and the private sector regarding transaction terms demonstrates the extent to which the Government of Japan went to ensure that its policies were followed by the industry. Repeated advocacy and monitoring built peer pressure and served to as a constant reminder that the Government was constantly watching. The United States also asserts that MITI applied pressure through the Chamber of Commerce. The Chamber has at its disposal a great deal of authority to influence the dispensing or withholding of government benefits, and also acts as an information gathering arm for MITI. Consequently, medium and small scale enterprises would have second thoughts before ignoring the Chamber's guidance on transaction terms.

¹⁹³Draft a Standard Contract for Film and Criteria for Standardization of Transaction Terms, Zenren Tsuho, August 1971, US Ex. 71-11. Japan disagrees with the US translation of this quote from the 1971 Standard Contract. See translation issue 8.

5.139 The United States further argues that to further promote standardization of transaction terms, MITI in 1971 commissioned the Japan Chamber of Commerce to draft standard contracts for 14 different products, including photographic film. This was followed by the publication by the Chamber in 1972 of the standard transaction contract for photographic film. The United States concedes that the Chamber standard contract did not mention standardization of transaction terms but asserts that the very publication of a standard contract by Japanese industry amounts to an exercise in standardization. Moreover, MITI continued its efforts to underlie the importance of standardized transaction terms. In 1973, MITI compiled and published under its name materials by the quasi-governmental Transaction Terms Stabilization Committee. This Committee's findings emphasized the importance of standardization of transaction terms as essential for systemization of distribution activities as well as being a countermeasure against foreign capital.

(i) **Impact of the Guidelines**

5.140 The **United States** further argues that in response to the direction given by MITI, Fuji and Konica implemented tough new transaction terms that increased their control over wholesalers and retailers. The Japanese photographic materials industry instituted an aggressive program of volume-based rebates and tightened payment terms for their distributors.

5.141 According to the United States, the new standardized trade terms had precisely the effect the Japanese Government intended. Volume rebates encouraged wholesalers to purchase from a single source (to achieve the rebate target) rather than from multiple sources, thereby promoting exclusivity. According to photo industry press and studies, the new transaction terms were instrumental in turning the wholesalers into exclusive agents of the Japanese manufacturers and in vertically integrating distributors.¹⁹⁴ The United States cites as an example, a Japanese study of the competition between Fuji and Konica published in 1980 which examined the factors behind distributors becoming Fuji's exclusive agents -- and pointed to progressive volume rebates as the main factor.¹⁹⁵ The United States further argues that the manufacturers' coordinated policy of tightening payment terms (payment rebates) strengthened the manufacturers, often at the expense of wholesalers.¹⁹⁶

5.142 The United States further asserts that the smaller wholesalers and retailers at first resisted these standardized terms, but were eventually pressured into submission. Another turning point, in the US view, was the 1968 bankruptcy of Chuo Shashin, a relatively large photo industry wholesaler. Consequently, wholesalers and retailers considered how best to avoid a similar fate and concluded that making independent business decisions entailed greater risk than following the dictates of the industry. The United States cites the following passage in support of their contention:

Tokuyakuten [primary wholesalers or special contract agents] realized the need to correct their sales postures after the [financial] failure of Chuo Shashin. If certain tokuyakuten take advantage of this opportunity and offer lower prices or long term, sight credit, customers will probably lean towards those with looser transaction terms. However, such tokuyakuten will have the same problem that Chuo Shashin had. That is why primary wholesalers should have tougher collection standards.¹⁹⁷

5.143 **Japan** responds that the bankruptcy of Chuo represented a dramatic example of the underlying business rationality of having reasonable payment terms. Thus, observers in this industry had a

¹⁹⁴Wholesale: So-called Keiretsu-ka Problem -- Course Unclear, Nihon Shashin Tsushin, 1 November 1967, US Ex. 67-14.

¹⁹⁵Niizu Sgigeyuki, Fuji Photo Film vs. Konishiroku, 1980, US Ex. 80-1.

¹⁹⁶Fuji Film's Result of Stricter Policy on Receivables, Zenren Tsuho, March 1968, US Ex. 68-2. Japan disagrees with certain US translations contained in Ex. 68-2. See translation issue 9.

¹⁹⁷Get ready for Breakthrough; Trade Normalization Further Advanced; Proposed to Increase Profit; Concern About Impact on Retailers, Camera Times, 19 March, US Ex. 68-3.

compelling business lesson of the importance of rational payment terms, a lesson that predated both the 1969 Survey in this industry and the 1970 Guidelines that formalized MITI guidance on this issue. This industry had no need to wait for MITI guidance before considering and taking action in accordance with individual economic self-interest. Indeed, the United States itself goes on to explain, that the Fujifilm primary wholesalers began tightening their payment terms to retailers, after the Chuo bankruptcy but before the 1970 Guidelines.

5.144 The **United States** argues that the pressure put on the primary wholesalers by the new transaction terms turned into an immediate loss for foreign manufacturers because once progressive rebates were introduced, the wholesalers had a strong incentive to deal only with the leading manufacturers - the Japanese producers. In addition, Fuji and Konica pressed their systemization efforts beyond the wholesalers down to the retailers. Despite initial resistance from retailers, MITI pressed forward with the Guidelines because of their importance as a liberalization countermeasure. This was strengthened further by the formulation of the 1971 Basic Plan.

5.145 **Japan** argues that the US allegations completely mischaracterize the 1970 Guidelines. According to Japan, the 1970 Guidelines explicitly discouraged the use of rebates and did not call for shorter payment terms. It is quite clear, in Japan's view, from what was actually written in the 1970 Guidelines, that they were unrelated and even inimical to the establishment of single-brand distribution.

5.146 Japan further argues this effort by the United States to avoid the text of the 1970 Guidelines overlooks several key points. First, the 1970 Guidelines say nothing about "progressive" rebates, and in fact discourage rebates generally. Second, although the 1970 Guidelines do encourage volume discounts, the stated rationale is for greater efficiency, not encouraging "channel exclusiveness." Third, even if one of the consequences of volume discounts is some tendency toward larger volume purchases from fewer suppliers, that business decision rests with the wholesaler. Regardless of the MITI recommendations, all of the actions -- either manufacturers deciding to offer discounts or wholesalers deciding to accept them -- are purely private business decisions.

5.147 According to Japan, as to payment terms, MITI's recommendations were also completely unexceptional. The 1970 Guidelines did not call for shorter payment terms.¹⁹⁸ MITI was merely stating that, after a certain period, suppliers should charge their customers interest for late payment. Late payment charges are not novel or unusual; rather they are a completely normal term of credit arrangement. It is simply not credible to contend that the institution of late payment charges is a draconian assertion of control by suppliers over their customers.

5.148 According to Japan, the United States argues that "wholesalers would no longer benefit from what amounted to easy credit from the manufacturers." Japan believes the US position would require the Panel to believe that a MITI statement simply that "[for promissory notes with unusually long sight], appropriate interest should be charged ..." set in motion the following chain of events: (1) all manufacturers will in fact change their policy; (2) the policy change will be so dramatic as to materially affect the wholesaler; (3) the wholesaler will be driven to financial desperation; (4) all suppliers but one will ignore its financial plight and insist on tighter terms; (5) a single supplier will craftily offer more flexible terms, and finally, (6) that wholesaler then will have no choice but to abandon all other suppliers' brands and instead reluctantly become dependent on a single supplier.

¹⁹⁸According to Japan, it should also be noted that, contrary to US assertions, the 1970 Guidelines do not call for uniform or rigid standard payment terms. In fact, the 1969 Survey, which led to the 1970 Guidelines, notes "Many wholesalers point to the period of payment collection, especially the period of draft site as an important issue of terms of trade. However, the draft site highly depends on the financial circumstances and the policies of individual enterprises at the time of each payment. Therefore, it is not appropriate to establish standards indicating that 90 days or 120 days are appropriate." 1969 Survey, p. 14, Japan Ex. B-1.

5.149 The **United States** requests the Panel not to place undue emphasis on a single phrase in the 1970 Guidelines that rebates "should be kept to a minimum". Instead, the Guidelines' recommendations should be considered in their entirety:

"Rebates are generally awarded at the discretion of the sellers. Therefore, rebates are widely used as a means of controlling the distribution process. However, their excessive use may constitute an unfair trade practice under the Antimonopoly Law. Even when it does not constitute a violation of law, the distribution process can in effect be controlled. Also, it may make it difficult for recipients [of the rebates] to formulate a clear management plan, and the final price may not fully reflect the merits derived from rebates. In addition, the rebate system has become very complicated in recent years, and the administrative burden of rebates has increased. In principle, discounts should be used as a means to reward consumers for the benefits of large quantity transactions. The use of rebates will be allowed as a supplementary means to achieve other price policies. However, the use of rebates should be kept to a minimum."¹⁹⁹

5.150 According to **Japan**, relationships between manufacturers and wholesalers were not even the focus of the 1970 Guidelines. MITI's 1969 Survey, which led to the issuance of the 1970 Guidelines, stated clearly that its analysis and recommendations were concentrating on transaction terms between wholesalers and retailers. Japan further asserts that the imposition of unfavourable terms by any manufacturer would have created incentives to switch suppliers, or at least add other suppliers so as to play them off against each other and thereby secure more favourable arrangements. Thus even accepting the United States' characterization of the 1970 Guidelines, in Japan's view, their effect logically would have been the opposite of what the United States contends.

5.151 Japan believes the starting point for analysis should be the Guidelines themselves, and what they said and did not say. Specifically, the Guidelines did not either mandate *uniform* transaction terms or provide *specific* transaction terms to be followed by manufacturers, wholesalers, secondary dealers, and retailers. The Guidelines did nothing more than make general suggestions related to payment terms, volume discounts and rebates. The United States has made no effort to establish that these payment terms are at all remarkable. In fact, the payment terms cited by the United States are common in many industries throughout the world. Moreover, payment terms are not the reason that the distributors chose to become single-brand or remain single-brand. Payment terms, even the unremarkable ones at issue here, are simply one element of the cost to the buyer.

5.152 Japan rejects the US argument that the wholesalers became more dependent on the manufacturers and, in particular, on volume discounts and rebates. First, it should be noted that the 1970 Guidelines did not encourage the use of volume discounts without reservation, and did it never encouraged rebates. The Guidelines encouraged transparency if volume discounts were given, and discouraged the use of rebates. Obviously, the more transparent the volume discount, the easier it would be for a competitor to provide the buyer an offsetting incentive (e.g., lower price) to purchase its product rather than the product of the manufacturer offering the volume discount. Thus, if anything, the encouragement of transparency in granting volume discounts improved the position of competitors with a customer.

5.153 The **United States** responds that the Japanese Government effectively ensured that wholesalers could not turn to alternative suppliers for more competitive transaction terms. The Japanese Government's advocacy and monitoring of standardized transaction terms -- both between manufacturers and wholesalers and between wholesalers and secondary wholesalers and retailers -- helped create the discipline to achieve standardization.

¹⁹⁹US Ex. 70-4.

(ii) **Timing**

5.154 **Japan** argues that, according to the United States, MITI's distribution policies during the 1960's and 1970's, i.e., the so-called "systemization" policies, formed the centrepiece of its alleged strategy to block imports of consumer photographic film and paper. Japan recalls that the United States argues that MITI encouraged and facilitated the creation of a closed and exclusionary market structure for consumer photographic film and paper. In Japan's view, however, there is no causal connection between the policies that were being followed by the Government of Japan and the resultant market structure.

5.155 Japan argues that the US theory has intractable timing problems. According to Japan, domestic manufacturers had begun to reform their payment and rebate policies in the early 1960's, long before the 1970 Guidelines. Fujifilm revised its existing volume rebate policy over a year earlier on 21 October 1966. This policy remained unchanged from 1966 until 1974.²⁰⁰ Fujifilm's volume discount policy therefore precedes both the 1970 Guidelines and the 1967 Cabinet Decision.²⁰¹ In addition, Fujifilm made no change in its policy in response to the 1967 Cabinet Decision. Fujifilm had already tightened payment terms in April 1966.²⁰² In fact, the average number of days required for Fujifilm to receive payment from its primary wholesalers had already dropped during the first half of fiscal year 1966, which began on 21 October 1965.²⁰³ Indeed, Konica began tightening its payment terms as early as 1962.²⁰⁴ In addition, three of Fuji's four major primary wholesalers were already single-brand distributors by 1968, two years before the guidelines were issued. While Fuji's fourth primary wholesaler, Asanuma, did not become a single-brand distributor until after the issuance of the Guidelines, it only made this private business decision after Kodak explicitly refused to deal with it directly. Japan goes on to state that, as to the other domestic manufacturer, Konica, all of its primary wholesalers had been single-brand distributors by 1955. According to Japan, therefore, there was no causal connection between the 1970 Guidelines and the development of single-brand wholesale distribution in the film sector. In Japan's view, the Japanese manufacturers had perfectly rational business incentives for taking these actions.

5.156 The **United States** responds that the Japanese photographic materials manufacturers instituted an aggressive program of volume-based rebates and tightened payment terms for their distributors in October and November of 1967, just a few months after the June 1967 Cabinet Decision's call for the industry to modernize distribution to resist foreign competition. Their move to implement these transaction terms was also consistent with the Second and Fifth Interim Reports' call for the greater use of "volume discounts" and a move away from long payment terms.²⁰⁵ The new terms included volume based rebates, in which wholesalers received rebates for reaching target sales volumes. They also included "payment rebates," in which the wholesalers received a rebate if they made prompt payment, but the amount of the rebate was reduced for each additional time period that payment was

²⁰⁰See Affidavit of Tanaka Takeshi, p. 3, Japan Ex. A-10.

²⁰¹According to Japan, while the United States claims that Japanese film manufacturers tightened payment terms in November 1967, it has misunderstood the article it cites to support this assertion. Manufacturers in fact tightened payment terms much earlier. Fujifilm, for example, tightened payment terms in April 1966. See Fujifilm's Result of Stricter Policy on Receivables, Zenren Tsuho, March 1968, US Ex. 68-2; Affidavit of Tanaka Takeshi, p. 3, Japan Ex. A-10. Japan argues that even if the date cited by the United States were correct, however, the fact remains that payment terms were tightened prior to the 1970 Guidelines.

²⁰²See Fuji Film's Result of Stricter Policy on Receivables, Zenren Tsuho, March 1968, US Ex. 68-2.

²⁰³Based on these average statistics, Japan notes that Fujifilm estimates that payment terms were tightened around 20 October 1965. Affidavit of Tanaka Takeshi, p. 3, Japan Ex. A-10. An article appearing in the Zenren Tsuho supports this assertion. Fujifilm's Result of Stricter Policy on Receivables, Zenren Tsuho, March 1968, p. 5-7, US Ex. 68-2. ("It is now clear that it was two years back, just before 20 April 1966 ... that Fujifilm started to try to improve its receivables and related shipments.")

²⁰⁴Affidavit of Haruyoshi Okuyama, p. 3, Japan Ex. A-18.

²⁰⁵Second Interim Report, US Ex.65-2; Fifth Interim Report, US Ex. 66-3.

delayed, and after the potential payment rebate reached zero, the volume rebate was reduced as payment delays continued. According to the US, these rebates were tantamount to tightened payment terms.

5.157 The United States continues that Japan actively pressed for standardized transaction terms in the 1968-75 time frame precisely as Japan was lowering its tariffs and moving toward this first significant liberalization of capital investment. MITI's repeated and active efforts to standardize the terms (including through publicizing the particular terms applied by individual wholesalers) served to standardize those terms at this time when standardization was most needed to resist the imminent threat of foreign competition. Japan's timing was right on the mark regarding the second goal as well. Although Japanese manufacturers had implemented rebates, volume discounts, and shortened payment terms before the 1970 Guidelines, the 1969 survey and the 1970 Guidelines themselves noted that rebates and volume discounts were less widely used between primary wholesalers and secondary wholesalers and retailers.

5.158 According to the United States, Japan admits it held off foreign investment in the distribution sector in order to ensure that foreign manufacturers could not establish their own distribution networks in Japan until Japanese manufacturers had restructured their own distribution networks and made them more efficient. The pressure put on the primary wholesalers by the new transaction terms turned into an immediate loss for foreign manufacturers. Prior to the institution of the Government-directed new transaction terms, two primary wholesalers served as major marketing and distribution channels for imported film: Asanuma, Japan's dominant photospecialty wholesaler, and Misuzu, another large nationwide wholesaler. However, once the progressive rebates were implemented, these wholesalers had a strong incentive to deal with only the leading manufacturers -- the Japanese producers. The shortened payment terms also weakened the wholesalers' financial condition, making them more vulnerable to control from the Japanese manufacturers.

(c) 1990 Guidelines

5.159 **Japan** points out that efforts towards distribution rationalization did not end in the 1970s. In 1990, MITI issued the "Guidelines for Improving Trade Practices".²⁰⁶ Not surprisingly, these Guidelines addressed many of the same traditional irrational business practices targeted by the various industry-specific trade rationalization guidelines 20 years earlier. This is proof that Japan did not change its basic policies. The objective of reforming traditional but outmoded distribution practices made sense in 1970 and it still made sense in 1990. Japan stresses that in recent years the United States has pressured Japan to be more aggressive in encouraging its industries to follow these policies.

5.160 Japan notes that the 1990 Guidelines emerged from an inquiry by the Minister of International Trade and Industry, who requested the Distribution Committee of the Industrial Structure Council to revisit the issue of distribution rationalization during the US-Japan Structural Impediments Initiative ("SII") talks. Japan indicates that after receiving the Distribution Committee's interim report, MITI sent the 1990 Guidelines, which constituted one part of the interim report, to 141 different industrial associations.

5.161 The **United States** concedes that the 1990 Guidelines arose out of international pressure on Japan to increase market access, including the SII talks between Japan and the United States. In response to that pressure, Japan introduced guidelines indicating that "international harmony is required" and businesses "must give consideration so as not to have their business practices become obstacles to others [including foreign suppliers]."²⁰⁷ This statement contrasts with the repeated calls to take countermeasures

²⁰⁶Shoukankou Kaizen No Kihonteki Houkou Ni Tsuite (Basic Direction for the Improvement of Commercial Practices), 20 June 1990, [hereinafter "1990 Guidelines"], US Ex. 90-5, Japan Ex. B-22.

²⁰⁷1990 Guidelines, p. 2, US Ex. 90-5.

"in order to prevent disorder arising from"²⁰⁸ the incursion of foreign capital enterprises, stated in many of the key documents from the late 1960's and early 1970's.

5.162 The United States contends that based on these positive statements, in various exchanges with the Government of Japan, it has taken the view that the 1990 Guidelines have the potential to help improve market access in the distribution sector (as Japan promised), if Japan in fact implements the policies indicated in these positive statements. According to the United States, however, Japan has not implemented these policies in the photographic materials sector (or indeed any other sector, as far as the United States is aware). Japan's failure to implement these policies led the United States to state, in its November 1996 submission to the Government of Japan on deregulation matters, that Japan should implement what these Guidelines provide for. Moreover, this failure of implementation led the United States to conclude that Japan in fact has not changed its basic policies on distribution, and in fact has not implemented the positions stated in the 1990 Guidelines to correct the restrictive structures in the distribution system for photographic film and paper.

5.163 The United States emphasizes that in considering the implementation of the 1990 Guidelines, it is important to bear in mind that Japan implemented its distribution policies, beginning in the 1960's and 1970's, not by a mere announcement of Guidelines in 1970, but based on the back-and-forth process of "concerted adjustment" between government and industry. That process spanned years and involved near-constant government surveying and consulting with the domestic industry, building consensus, issuing reports and guidelines, following up with more surveys and guidance to industry. It was the combination of these actions -- the leadership, monitoring, and close follow-up by the Government -- that made effective the Japan's policies to limit foreign access to the its distribution system. Thus, it would take even greater efforts by MITI to undo what it has done, particularly because the formation of this system in the first instance was in the interest of Japanese manufacturers, whereas its dismantling would pose a direct challenge to the two-company oligopoly of Fuji and Konica.

5.164 The United States argues that as far as it is aware, Japan has undertaken no actions in the photographic film and paper sector to follow-up on the 1990 Guidelines. Specifically, MITI has not pursued any meaningful actions to reverse its policies on transaction terms or to address the restricted structure of the distribution system for photographic film and paper in Japan. Moreover, the exclusionary distribution system remains in force in the form it existed in 1990, and an elaborate system of rebates and discounts continues at various levels of the distribution system in this sector.

5.165 The United States further argues that in addition, nothing in the 1990 Guidelines indicates that MITI no longer favours standardized transaction terms as a means to blunt competition from foreign manufacturers. Japan's interpretation of the Antimonopoly Law continues to provide that the use of transaction terms departing from standard industry terms can be an unfair trade practice, and the Antimonopoly Law continues to require reporting of all contracts between foreign manufacturers and Japanese distributors.

5.166 According to **Japan**, the 1990 Guidelines address many of the same traditional irrational business practices targeted by the various industry-specific trade rationalization guidelines 20 years earlier. For example, the 1990 Guidelines note that many of the rebates paid by wholesalers and manufacturers are based on complex or unclear criteria, that unsold merchandise is often returned, that frequent small deliveries are required at the suppliers' expense, and that suppliers often dispatch employees to expand the sales force of retailers.²⁰⁹ Just as in the various industry specific guidelines of the 1970's, the 1990 Guidelines suggest as "directions for improvement" that rebate conditions be clarified and that the use of rebates be kept to a minimum, that returns should not be allowed except in cases where the merchandise has been damaged or is defective, that the cost burden for deliveries be shared equitably

²⁰⁸1970 Guidelines, US Ex. 70-4.

²⁰⁹1990 Guidelines, pp. 2-4, 5, 8-9, Japan Ex. B-22.

between suppliers and retailers, and that the practice of dispatching employees be limited to cases in which the supplier has something to gain and is not being coerced by the retailer.

5.167 Japan argues that the close similarities of the 1970 Guidelines and the 1990 Guidelines are not at all surprising from its perspective, but they possess a serious problem for the US claims. From a Japanese perspective, both sets of guidelines pursue the same basic policy agenda, i.e., eliminating "irrational" business practices to modernize the Japanese distribution industry. From the US perspective, there must be some reason why the 1970 Guidelines are a problem while the 1990 Guidelines are sound policy that should be encouraged. Japan argues that as recently as in November 1996 the official US position was that MITI should "monitor and report" on the Japanese industry's compliance with the 1990 Guidelines "in order to promote a free, transparent, and competitive distribution system."²¹⁰ This US Government request is completely consistent with the Japanese Government's view of its distribution modernization policies, but it is at odds with the theories presented by the US to this Panel.

5.168 The **United States** counters, however, that with respect to rebates, the 1990 Guidelines depart in an important respect from the many policy documents of the late 1970's addressing transaction terms. Specifically, regarding rebates, the United States stresses that the 1990 Guidelines emphasize that:

It is desirable for manufacturers to voluntarily refrain from offering rebates aimed at maintaining a keiretsu-based relationship in order to prevent manufacturers from exercising excessive influence over the business of retailers.²¹¹

5.169 In **Japan's** view, the major difference between the 1990 Guidelines and the earlier ones is that now modernization is specifically identified as necessary for (among other things) improving imports' access to the Japanese market.²¹² Therefore, opaque rebates were criticized because new foreign entrants would have trouble knowing what terms they would have to offer to be competitive.²¹³ Requirements for frequent small deliveries were also characterized as hindering the entry of imported products into the marketplace.²¹⁴

6. *OTHER DISTRIBUTION "COUNTERMEASURES"*

5.170 According to the **United States**, Japan took additional steps to ensure that foreign firms could not utilize their capital strength to attract wholesalers by providing more favourable transaction terms than those offered by domestic firms. Two mechanisms for accomplishing this were (1) to severely limit foreign firms' ability to offer financial inducements to distributors, and (2) to subject foreign firms to anti-monopoly scrutiny if they departed from the standard transaction terms that the government had mandated.

(a) **JFTC Notification 17**

5.171 The United States notes that on 20 May 1967, the JFTC issued Notification 17, "Restrictions on Premium Offers to Businesses."²¹⁵ Notification 17 essentially prohibits a consumer goods manufacturer from offering cash or other "premiums" to wholesalers or retailers as an inducement for the wholesaler or retailer to begin handling the manufacturer's products, or to reach a certain level

²¹⁰Submission by the Government of the United States to the Government of Japan Regarding Deregulation, Administrative Reform and Competition Policy in Japan, 15 November 1996, p. 7, Japan Ex. B-23.

²¹¹1990 Guidelines p. 8, US Ex. 90-5.

²¹²1990 Guidelines, p. 2, Japan Ex. B-22.

²¹³Ibid., p. 2.

²¹⁴Ibid., p. 8.

²¹⁵US Ex. 67-4.

of sales of a manufacturer's product. Notification 17 took away an important means a foreign manufacturer could otherwise have used to attract customers.

5.172 The United States asserts that Item 2-4 of Notification 17 contained an exception to its prohibition on inducements to distributors that allowed a manufacturer to offer premiums to employees of distributors and retailers who were in exclusive, vertically-integrated relationships with the manufacturers. The Japanese manufacturers who had achieved exclusive dealing arrangements with wholesalers or retailers, could offer unlimited premiums (including cash) to the employees of those wholesalers and manufacturers. Foreign manufacturers, which had no direct relationships with Japanese wholesalers because of Japan's requirement that they deal with a sole import agent, were prohibited from offering such inducements. The United States further asserts that the JFTC described this Notification as "a breakwater before liberalization."²¹⁶

5.173 **Japan** responds that low price offers, rebates and offers of goods to assist the other parties' promotional activities were outside the scope of the Notification. Although the United States would like to give the impression that "photographic materials" were expressly singled out as one of the industries covered by the Notification, almost all the industries producing goods consumed or used in every day life - more than 100 industries ranging from automobiles to soap - were covered. In any event, the regulation restricted only excessive premium offers - not normal promotional activities - to distributors. The rationale was that such offers could impair fair and free price competition in the distribution and could increase the distribution cost to the detriment of consumer interests.

5.174 Japan further argues that the US argument concerning Item 2-4 of the Notification contains a fundamental misunderstanding. Premiums offered to employees of companies which were in a special relationship (share holdings or sending executives) with the manufacturer were not considered premiums under the regulation, because they were no different from premium offers to its own employees. This exception applied only to transactions which were virtually identical to operations within a single entity. Fuji and its primary wholesalers were not eligible for the exception because they were not in a special relationship.

5.175 Japan indicates that as price competition intensified at the distribution level due to changes in the Japanese economy since 1967, distributors tend to demand lower prices, rather than premiums, from the manufacturers. The need for the regulation declined, commensurate with the trend. For these reasons, the Notification was abolished in April 1996 in the course of the review of the Premiums Law. In Japan's view, it should fall outside the scope of the present proceedings.

5.176 While the **United States** concedes that Notification 17 has been repealed, it maintains that there are other provisions that make that repeal meaningless. According to the United States, premiums from manufacturers to wholesalers are still subject to JFTC Designation 9 of JFTC Notification 15 of 1982. This provision governs the use of "unjust inducements" under the Antimonopoly Law and prohibits premium offers in excess of "normal business practice".

5.177 **Japan** responds that JFTC Designation 9 of JFTC Notification 15 of 1982 does not violate the WTO Agreements. Moreover, Japan emphasizes that Designation 9 has not been specifically identified in the US panel request and thus is outside the Panel's terms of reference.

(b) International contract notification

5.178 The United States argues that through the Transaction Terms Standardization Committee report and the 1970 Guidelines, MITI worked to develop standard transaction terms and to ensure that domestic

²¹⁶Severe Restrictions Placed on Business for Premium Offers: Shatokuren Hears JFTC Explanation at Jyosui Kaikan on the 12th. Nihon Shashin Kogyo Tsushin, 20 June 1967, US Ex. 67-8.

industry would follow them. Japan found an effective tool to achieve this objective through the use of the international contract notification provision of the Antimonopoly Law. Article 6 of this Law requires parties entering into an "international agreement" or "international contract" to submit a copy of the contract to the JFTC. Contracts between domestic firms are not subject to similar notification requirements. The discriminatory reporting requirement, coupled with the use of administrative guidance, formed an effective combination of tools for discovering and preventing the use of transaction terms that were not in accord with the systemization policy.

5.179 According to the United States, therefore, although domestic manufacturers were free to execute distribution agreements without the notification to an examination by the JFTC, contracts involving foreign manufacturers were subject to the international contract notification to, and examination by, the JFTC. In addition, the responsibility to notify rested with the domestic distributors. The result is that if a foreign producer had offered a wholesaler more favourable terms than those called for by the Japanese Government, the wholesaler would have had to submit a copy of an international contract that blatantly revealed that the company was challenging Japanese Government policy and measures. For the United States it follows, therefore, that if foreign manufacturers offered wholesalers more favourable terms than domestic manufacturers, those contracts would be brought to the attention of the Japanese Government.

5.180 **Japan** responds that the provision of the Antimonopoly Law concerning international contracts has its basis in the prohibition of participation in any international cartel under the 1947 Imperial Decree issued during the Allied Occupation. The notification requirement serves to ensure compliance with the prohibition, and has existed since 1947. In Japan's view, it is very obvious that the mechanism was not designed as part of "countermeasures" for rationalization of the distribution against foreign investments. The review by the JFTC is concerned only with competition policy, and does not examine whether or not the conditions were favourable to Japanese distributors nor does it serve as a guide for applicants to modify contracts in favour of Japanese distributors.

5.181 The **United States** points out that the JFTC's 1971 annual report shows that the international contracts of foreign manufacturers were scrutinized by the JFTC.²¹⁷ According to the report, the JFTC took action to ensure that import agents complied with the international contract notification requirement, received 484 notifications from import agents, and gave particular attention to film import agents.²¹⁸ This scrutiny inhibited foreign firms from offering attractive terms to wholesalers while the systemization program was being put in place. The JFTC's report indicates that the JFTC's purpose was to solve "problems resulting from liberalization of the Japanese economy involving international transactions," and that Rule No. 1 of 1971 was a "first step" toward addressing these "problems."

5.182 The United States notes that Japan argued that US manufacturers' activities in Japan were not subject to this international contract notification provision. In fact, Rule No. 1 made clear that international contract notification applies to contracts "between a domestic business and a foreign business ... for the purpose of conducting continuous sales ... in which the purchaser is [re]selling to a third party."²¹⁹ Thus, sales from Kodak to its import agent, Nagase, were covered by this provision. Moreover, any relationship between Kodak and Japanese wholesalers would be subject to this provision as well. Equally important, the United States pointed out that the JFTC has relied extensively on informal guidance in taking action under the international contract notification provision. The United States referred to the explanation of a Japanese scholar that the JFTC may legally apply guidance under the contract notification provision even if the JFTC does not have enough evidence to conclude that an Antimonopoly Law violation exists. The expert noted that "in Japan, corrective (administrative) guidance, in the context of the notification system, has ensured the effectiveness of restrictions on

²¹⁷JFTC Annual Report 1971, US Ex. 71-4.

²¹⁸Ibid.

²¹⁹Ibid.

international contracts."²²⁰ This use of informal guidance, combined with the need to report international contracts, has chilled the ability of foreign manufacturers to offer more competitive terms.

5.183 **Japan** responds that the JFTC Annual Report of 1971 merely notes that the JFTC urged various industries (e.g., western liquor, lemon, fountain pens) to notify international contracts, and that it did not exercise any guidance with respect to film products. Only 13 cases of guidance were given to all industries and no guidance was given to the photographic industry. Moreover, not all international contracts had been required to be notified, and the contracts between Kodak Japan Limited and Japanese distributors were not required to be notified under the Antimonopoly Law.

5.184 Japan emphasizes that, while the requirement for international contract notification was technically still in effect at the initiation of this Panel proceeding, a bill to repeal the international contract notification requirement was passed by the Japanese Diet in June 1997 which amended Article 6(2) of the Antimonopoly Law and simultaneously abolished JFTC Rule No. 1.

7. SYSTEMIZATION: PHYSICAL AND INFORMATION LINKS

5.185 The **United States** argues that simultaneously with MITI's policy to standardize transaction terms, MITI promoted two other types of linkages between manufacturers and distributors. First, MITI provided financial and managerial support to encourage "physical" ties, particularly joint distribution centers, for which Japanese manufacturers and distributors would share control, operations, and often ownership. Second, MITI provided support for the development of inter-company computer ties to specific sectors attempting to systemize distribution channels. In the US view, such "informational" ties bind distributors together under the dominance of manufacturers.

(a) Physical links and the 1975 Manual

5.186 The United States alleges that an important element of the systemization program was the regulation of the physical movement of goods through the distribution system in such a way as to encourage the vertical alignment of wholesalers and retailers under individual Japanese manufacturers. Japan used guidance and financial incentives to persuade manufacturers, wholesalers and retailers to cooperate in the establishment and use of centralized joint delivery and processing centers. A government-coordinated effort assured that this interweaving of a Japanese manufacturer with multiple wholesalers and retailers would tighten the bonds between the firms in a vertically integrated system, enhancing the manufacturers' control over its distributors. It is alleged that the Sixth and Seventh Interim Reports of the Distribution Committee introduced this policy.

5.187 According to the United States, the Seventh Interim Report called for distribution "to progress from a basis of centralized processing of physical distribution control at distribution centers ... established jointly by multiple companies or the entire industry".²²¹ It indicated that as part of the process of physically integrating distribution operations, the manufacturers, wholesalers and retailers would need to (i) unify product codes or transaction codes, (ii) standardize business forms and (iii) standardize packing types. The United States argues that these steps would tie participating companies closer together and make it more cumbersome to transact business with companies that did not operate in accordance with these standards.

5.188 In **Japan's** view, as the Industrial Structure Council's Distribution Committee itself recognized, standardization of distribution practices should make the Japanese market more permeable by imports, not less. Specifically, its Seventh Interim Report in 1969 recognized that "one effect of systemizing Japan's distribution system is the simplification of entry [into Japan's market] by foreign capital, which

²²⁰Murakami Masahiro, Dokusenkinshiho [Antimonopoly Law], 15 March 1996, p. 19, US Ex. 96-4.

²²¹Seventh Interim Report, p. 7, US Ex. 69-4.

are more adept at systems methodology."²²² Standardization would alleviate the burden of having to adjust to hundreds or thousands of individualized ways of doing business, and thus should facilitate market penetration by outsiders.

5.189 The **United States** notes that Japan selectively quotes only the first half of a sentence in the Seventh Interim Report. The second half of the sentence makes clear that allowing foreign enterprises to lead systemization was the last thing Japan wanted:

"While it is true that one effect of systematizing Japan's distribution system is the simplification of entry [into Japan's market] by foreign capital, ... we should instead emphasize preventing the immense impact that would be felt if foreign capital took the lead in systematizing Japan's distribution activities, and quickly develop a system sufficiently capable of resisting the rational systems introduced by foreign capital." ²²³

5.190 The United States further submits that Japan continued to direct physical linkages among manufacturers, wholesalers, and retailers in the 1971 Basic Plan for the Systemization of Distribution and the 1975 Manual for the Systemization of Distribution by Industry (Camera and Film). The Photosensitive Materials Committee, which was established following a recommendation in the Manual, produced the Distribution Center Facilities Basic Plan. The Plan described as its purpose, according to the United States, to improve distribution in response to "liberalization" in the photographic film and paper sector. The Plan set forth a blueprint for establishing joint distribution facilities between manufacturers and distributors. The United States also alleges that the Government of Japan provided financing to help Konica form a joint distribution center with the four large photospecialty wholesalers through which it had been marketing and distributing its products. The Photosensitive Materials Committee recommended to MITI that the project be funded by the Japan Development Bank.

5.191 The United States further asserts that in 1975, the Distribution System Development Center (DSDC), another MITI creation, and a photography industry "working group" produced a detailed Manual²²⁴ for the systemization of distribution in the film and camera industries. According to the United States, the Manual made clear that it was prepared as part of MITI's policy on systemization. The Manual emphasized that systemization meant integration among firms. The Manual allegedly noted that Japan had lifted quotas on film imports in 1971 and reduced tariffs. As a result, the Manual indicated that Kodak had been able to lower its prices to within a few yen of domestic producers' prices and that imports of Kodak film and paper were rising. The Manual stressed the need "to improve the structure of manufacturers to a capacity that will resist foreign-capital affiliated firms".²²⁵ The Center expressed hopes for widespread adoption of the Manual by the industry.

5.192 The United States further argues that to ensure continued government-industry cooperation to advance systemization, the Manual called for the establishment of another government-industry body, the Distribution Systemization Promotion Conference in the Camera and Film Industry. This organization was supposed to promote systemization of distribution through surveys, information processing activities, research and development, and standardization activities.

5.193 **Japan** responds that the information and recommendations contained in the 1975 Manual were directed toward MITI for internal use, not private industry. According to Japan, therefore, the 1975 Manual can in no way be considered to have had a binding effect on private industry. The 1975 Manual does, however, contain a few suggested recommendations in its final six pages including that:

²²²Ibid., p. 4.

²²³Seventh Interim Report, p. 4, US Ex. 69-4.

²²⁴Distribution System Development Center, Manual for the Systemization of Distribution by Industry (Camera and Film), March 1975, [hereinafter "Manual"], US Ex. 75-5.

²²⁵Ibid., pp. 27 and 122.

- (i) transaction terms (such as payment terms, rebates, ordering practices) be improved and standardized;
- (ii) the various document forms and codes used in the camera and film industries be standardized and unified;
- (iii) the efficiency of the distribution of cameras and film be improved (through measures such as the standardization of units, the standardization of pallet sizes, and a reduction in the frequency of deliveries); and
- (iv) the quality of information management be improved through the introduction of computers.

5.194 Japan emphasizes that the Manual was submitted to MITI by the Distribution Systems Research Institute for the internal use of MITI and not the other way around. The 1975 Manual was never released outside the government.

5.195 According to Japan, there is no basis for assuming that MITI's systemization policies had any exclusionary impact. MITI's policies recognized and addressed all distribution channels for film, including distribution channels used by imports. Nagase's subsidiary Kuwada, a single-brand primary wholesaler for Kodak, was a member of the wholesalers' trade association ("Shashoren") at the time MITI's 1975 Manual was prepared,²²⁶ and Kodak was thus in a position to access information contained in the Manual. Imports were not left out of the process. There is thus no reason to think that imports would have encountered difficulties because they did not share the same standardized forms and practices.

5.196 Japan's position is that the objective of these policies was to foster computerization and standardization of business forms and practices so as to improve information flow through the distribution system. Accordingly, the subject matter of these policies was often very dense and technical: e.g., uniform invoice forms, standard pallet sizes, and other very specific recommendations. There was not a hint of anti-import conspiracy.

5.197 The **United States** responds that however innocent these policies may seem, they had an indirect effect of fostering vertical integration by encouraging closer coordination, greater sharing of information, and standardization of forms and practices between manufacturers and wholesalers. According to the United States, systemization made it harder for foreign producers to convince domestic distributors to carry their products, since they were already so closely linked with domestic manufacturers.

5.198 **Japan** further asserts that the United States presents no evidence of any business changes implemented pursuant to MITI recommendations that actually had the effect of making wholesalers less likely to carry imported brands of film. In Japan's view, the United States has the burden of proving its allegation that these facially neutral policies serving valid domestic policy objectives had the effect of hindering imports; it is not up to Japan to prove the negative.

(b) Information links

5.199 The **United States** argues that related to the physical integration of distribution, Japan's systemization policy also encouraged computer linkages among Japanese manufacturers and their wholesalers. It was envisaged by the Japanese Government that information links would enhance efficiency in distribution, and would also allow the manufacturer to know if any of the "systemized" wholesalers dealt in significant quantities of a competitors' products. Japan recognized that such

²²⁶1975 Manual, at the list of "Collaborators in Study," US Ex. 75-5.

computer ties would foster ties between a Japanese photographic materials producer and its distributors by raising the transaction costs of dealing with outsiders. In addition, Japanese manufacturers commonly use such systems to "stabilize" or control distribution channels through the monitoring of distribution systems. The United States indicates that a 1996 JFTC²²⁷ study concluded that such manufacturer-distributor computer ties increased efficiency and also gave rise to three significant challenges for competition:

- (i) preventing competitors' entry into distribution;
- (ii) maintaining prices; and
- (iii) stabilizing transaction relationships between manufacturers and distributors.

5.200 The United States argues that MITI saw the development of information links as an integral part of its distribution systemization efforts and, therefore, advocated computer linkages to cement the vertical distribution system. After identifying the importance of information links, MITI created beginning in the mid-1970's, a series of government-industry entities to facilitate the creation of computer networks between Japanese manufacturers and Japanese distributor. The United States asserts that the Japanese Government also worked closely together with private companies to develop computer ties and address the variety of obstacles they faced in achieving this goal, including through low-interest financing.

5.201 According to the United States, Japan was well aware that creating information links between manufacturers and their distributors entails the risk of enforcing oligopolistic distribution structures and limiting competition. The United States points to a JFTC study as evidence of this.²²⁸ In addition, it cites the Distribution Committee's Ninth Interim Report²²⁹, which it alleges reiterates the importance of strengthening information ties necessary to strengthen horizontal and vertical linkages:

"The basic plan for the method of advancing information of the distribution sector is as follows. ... Second, is to offer guideposts on the ways individual or multiple companies through cooperation can engage in information activities. One can think of many situations with respect to the latter, in particular, such as a cooperative type that works horizontally among the businesses; a type that *clusters client retailers around a powerful wholesaler that serves as its nucleus; a type where the fulcrum is an organized system of integrated wholesale centers* and the wholesale business districts, etc. Guidelines should be established for each of these" ²³⁰

5.202 The United States further argues that the 1971 Basic Plan for Distribution Systemization²³¹ called for the strengthening of information ties as a key element of distribution systemization. The United States asserts that the plan specifically called for the creation at the national economic level of distribution information networks, the implementation of joint information activities, and the creation of special organizations to promote the provision of distribution information. The plan stated "such systemization of distribution must be realized through various stages: vertically from the intra-firm level, horizontally on the inter-firm level to the national economic level. Furthermore, in seeking to implement this, sufficient attention must be paid to the introduction of computers as an effective means of achieving [such systemization]."²³²

²²⁷JFTC Investigation Division Information Management Office (Yamamoto Takeshi, Distribution 3 Problems and the Antimonopoly Law, 2 June 1996), US Ex. 96-6.

²²⁸US Ex. 65-5.

²²⁹Industrial Structure Council Distribution Committee, Distribution for the 1970's (Ninth Interim Report), 22 July 1971, US Ex. 71-9.

²³⁰Ibid. pp. 80-81 (emphasis added).

²³¹1971 Basic Plan, US Ex. 71-10.

²³²Ibid., p. 4.

5.203 **Japan** responds that the United States presents no causal connection between the alleged guidance and support of the Distribution Systemization Development Center as given in the 1975 Manual, and the establishment by Japanese film manufacturers of on-line computer links with their primary wholesalers. In fact, according to Japan, Fuji, the leading domestic manufacturer, did not establish its first on-line connection with a primary wholesaler until 1989.²³³ Thus, Japan contends that, the alleged systemization guidance that the United States claims was so effective in creating an exclusionary market structure was in reality ignored for at least fourteen years.

5.204 The **United States** responds by citing a series of MITI actions to implement the integration of distributors' and domestic manufacturers' computer systems that began with the 1975 Manual. The key developments in MITI's assistance to this sector occurred in 1975, 1976, 1985, 1986, 1987, 1988, and 1989 (the year that Japan claims Fuji's system was completed). The US arguments concerning the assistance by the Japanese Governments in creating electronic information links during the period between the publication of the 1975 Manual and the establishment of on-line connections between Fuji and primary wholesalers in 1989 are described in more detail in section VI.D.3.(f) on "Electronic information links".

(c) MITI/SMEA support for systemization

5.205 The United States alleges that with the growth of colour photography in the late 1960's and 1970's, the importance of photoprocessing laboratories grew. However, the technology and capital equipment necessary to process colour film were beyond the reach of most small photo retailers. With the Japanese Government's financial support, the manufacturers stepped in, establishing colour laboratories and providing photographic paper and developing and processing services. These laboratories were an important distribution channel for film because of the laboratories' strong ties to its retail customers and its daily deliveries to them.

5.206 The United States further argues that the Japanese Government's support to domestic manufacturers solidified their control of this distribution channel. Japan provided funding under MITI's Small and Medium-Sized Enterprises Act (SMEA). During the 1967-70 period, SMEA provided at least 160 million yen to the effort of laboratory conversion. Aided by this government funding to the laboratories, Fuji and Konica allegedly rapidly developed strong networks of affiliated laboratories, which used their photoprocessing equipment, chemicals, and paper. Accordingly, foreign firms were put at a strong disadvantage since they were unable to obtain this assistance. Approximately 84 percent of the nearly 1,700 laboratories fall under the umbrella of one of the Japanese manufacturers and are commonly affiliated with retail outlets.

5.207 The United States submits that in 1973 the photoprocessing laboratories were designated as eligible for another SMEA subsidy program. The United States notes that the laboratories are a service business. Consequently, lowered tariffs on photoprocessing equipment and a strengthened yen would decrease the cost of imported photoprocessing equipment and materials, and therefore improve the laboratories' bottom line. Liberalization would be a threat to the laboratories only if they were tied in relationships with Fuji or Konica and did not feel free to purchase cheaper imported equipment and materials. In this situation, concessionary government financing could help reduce the comparative cost of purchasing domestic equipment and materials, and therefore help form or continue the bonds between laboratories and domestic film and paper manufacturers.

5.208 The United States asserts that the administration of the SMEA financing programs helps ensure that loans are dispensed in conformity with MITI industrial policy. Loans are approved on a case-by-case basis, at the discretion of a MITI certified management consultant. These policies have contributed

²³³Affidavit of Tanaka Takeshi, pp. 3-4, Japan Ex. A-10.

to Fuji's strong and excessive ties with photoprocessing laboratories in Japan, and it is these ties that have reinforced Fuji's dominant position in the market. Kodak has extended substantial efforts to develop a laboratory network in Japan, and has been disadvantaged by the extensive ties between Fuji and the laboratories fostered by Japanese Government subsidies.

5.209 **Japan** disagrees with the conclusion that 84 percent of the laboratories in Japan fall under the umbrella of Fuji. According to the data given in Photo Market 1996, of the 753 amateur laboratories in the Japanese market, 292 laboratories (38.8 percent) are affiliated with Fuji, 124 laboratories (16.5 percent) are affiliated with Kodak, 216 laboratories (28.7 percent) are affiliated with Konica, and 121 laboratories (16.1 percent) have other affiliations.

5.210 Japan further contends that the US arguments are unpersuasive for a number of reasons. Firstly, the financing was designed to help small laboratories, not the major manufacturers. Laboratories receiving the financing were free to choose the type and brand of all the equipment they acquired with the help of these loans. Once the laboratories obtained the new equipment, they were available as customers to anyone who could supply them the colour paper they would need to use the new technology. Therefore, this independent source of financing actually reduced any dependence the laboratories would have on the manufacturers. Japan points out that the United States does not even offer any argument as to why SMEA financing would favour Japanese manufacturers rather than any other supplier with a competitive product. Japan also points out that SMEA loans continue to be made and are available to laboratories affiliated with both foreign and domestic manufacturers. According to Japan, the trend toward affiliation with manufacturers actually began long before any of the alleged government efforts to integrate the photofinishing laboratories came into effect. Both Fuji and Konica were beginning to develop affiliations with its laboratories by the early 1960's.²³⁴

5.211 Japan points out that the US argument implies that affiliations between photosensitive materials manufacturers and photofinishing laboratories in the Japanese market are somewhat unusual and exclusionary. In Japan's view, such affiliations are common throughout the world. Strong market incentives favour forward integration by manufacturers into photofinishing. The demand for photographic paper is ultimately a function of the demand for photographic prints. Consequently, manufacturers have a strong incentive to participate in the downstream photofinishing market. Thus, the structure of the Japanese paper market is a reflection of rational business decisions, not government measures.

5.212 With respect to US allegations about MITI's financial support for systemization, Japan responds that the United States cites only a single example where Konica was able to receive funding from the Japan Development Bank (JDB) to develop a distribution facility. This JDB loan came too late to encourage vertical integration as Konica and its wholesalers were already affiliated.²³⁵ Therefore, for Japan, it is misleading to suggest that cooperation between Konica and its primary wholesalers and their joint development of a distribution facility is the result of some government plan to strengthen the relationship between these primary wholesalers and Konica. Japan further emphasizes that in any event JDB does not evaluate applications from foreign enterprises or from enterprises that carry foreign products any differently than it evaluates applications from enterprises that carry domestic products. In fact, since 1984, JDB has been promoting imports by providing loans for the construction of distribution facilities and services for imported products.²³⁶

5.213 The **United States** contends that while Japan argues the JDB would provide the same type of loan for establishing joint distribution facilities to a foreign manufacturer, the fact remains that the only manufacturer who received such a loan was Japanese.

²³⁴Affidavit of Tanaka Takeshi, p. 5, Japan Ex. A-10.

²³⁵See Affidavit of Haruyoshi Okuyama, p. 1, Japan Ex. A-18.

²³⁶JDB Annual Report 1995, pp. 26-27, Japan Ex. B-36.

8. *POST-1975 DEVELOPMENTS*

5.214 The United States argues that with the vertically integrated, exclusive distribution system in place, the Government of Japan turned its attention to measures that have helped maintain the structure. In its efforts to suppress the clearest challenge to the vertically integrated system, Japan has focused on new or strengthened measures to ensure that foreign manufacturers could not use their financial or marketing strengths to increase their foothold in the Japanese market.

5.215 The United States asserts that the Government of Japan has continued its close coordination with Japanese industry to implement industrial policy favouring Japanese manufacturers. It cites as an example, the 1990 MITI issued Guidance for Improving Business Practices, which it contends indirectly affirmed the continued use of rebates. It also cites Japan's 1995 enactment of the Special Measures Law to Promote Business Reform for Specified Industrialists (Business Reform Law), which allegedly establishes a broad legal framework for MITI's continued intervention to strengthen and protect domestic industries. This law allows for the designation of specified industries, and by ministerial order, MITI has designated "camera and related products manufacturers" and "camera and photographic materials industry" as specified industries.²³⁷ The United States further refers to a 1994 Japanese industry journal article that noted changes in the Japanese film distribution system, such as a revision of the rebate schemes and the opening of more discount stores, but concluded that "a limit to the expansion of sales channels seems to be appearing" and that "the actual network has not changed much."²³⁸ Other Japanese analysts have concluded that distributors remain highly dependent on manufacturers.²³⁹

5.216 **Japan** denies any coordination with industry designed to favour Japanese manufactures. Japan specifically notes that the 1990 Guidelines suggest that rebate conditions be clarified and that the use of rebates be kept to a minimum. Japan also rebuts that the US description of the "Business Innovation Law"²⁴⁰ is misleading, noting that the law treats foreign-affiliated firms and domestic ones on an equal basis. Japan asserts that the government has discouraged exclusionary practices in the photographic film industry. Japan claims that distribution practices in the film industry have been closely scrutinized by the JFTC to guard against possible anti-competitive practices.

5.217 Japan cites as an example situations when "parallel price increase" have been reviewed. Although these industry wide surveys - which have included Fuji, Konica, and Kodak - found no violation of the Antimonopoly Law, the fact that the surveys were conducted confirms that the JFTC has been particularly vigilant in monitoring developments in this industry. Japan, therefore, concludes that the US theory of a government conspiracy to create an exclusionary market structure is not supported by the facts.

5.218 The **United States** emphasizes, that in considering Japan's recent formal and informal actions, it is important to recognize that the distribution structure set up by the measures beginning in the 1960's and 1970's is, to a large extent, self-sustaining. Once Japanese manufacturers achieved domination over the distribution system through implementation of short payment terms, rebates and discounts, vertical information links, and other measures advocated and implemented by the Japanese Government, the manufacturers' power allows them to maintain such domination, through the continuing use of these transaction terms and other mechanisms, with less need for support from the Government. However,

²³⁷MITI Ministerial Ordinance No. 31 of 1995, Items 123 and 164, US Ex. 95-5.

²³⁸Distributors in Tough Environment; The Distribution Structures Continue to Change, Nihon Shashin Kogyo Tsushin, 1 May 1994, US Ex. 94-10. Japan disagrees with the US translation of the quote from the above-mentioned article. See translation issue 3.

²³⁹Four Fuji-Group Distributors Reported Unimpressive Results in Spite of Low Interest Rates, Shukan Shashin Sokuho, 24 June 1994, US Ex. 94-11. Japan disagrees with the US interpretation of this article. See translation issue 10.

²⁴⁰Japan notes that the proper translation should be the "Business Innovation Law" rather than the "Business Reform Law". Japan's further explanation about this law is discussed below in section VI.D.3.(h)(ii).

a reduced need for support does not mean that the Japanese Government reversed its policy. To the contrary, the United States asserts, Japan has continued to advocate short payment terms, rebates and discounts, and vertical information links, and Japanese manufacturers and wholesalers have continued to apply these practices to maintain the oligopolistic distribution system. The United States concludes that, moreover, Japan has continued to suppress alternative channels and potential challenges to this system, such as large stores and independent photoprocessing laboratory networks, thereby shielding the oligopolistic distribution system from competitive pressures that could undermine it.