D. UPSETTING THE COMPETITIVE POSITION OF IMPORTED PRODUCTS

1. THE LEGAL TEST

6.243 The **United States** claims that Japan, by its promulgation and application of the distribution countermeasures, the Large Stores Law, and promotion countermeasures, worked to "systematically offset" the intended effects of its tariff concessions. According to the United States, Japan identified in a systematic fashion the advantages it believed that foreign firms and products enjoyed, then designed policies and implemented measures to offset those advantages. As a consequence, the application of these three groups of countermeasures upset the competitive relationship between imports and domestic products in the Japanese market contrary to Article XXIII:1(b).

6.244 The United States notes that only a few disputes have resulted in a finding of nullification or impairment within the meaning of Article XXIII:1(b), but each panel addressing the issue has emphasized the importance of protecting a party's reasonable expectations that tariff concessions will lead to improved market access and will not be frustrated. For example, the panel in *EEC - Oilseeds* considered that

> "…the main value of a tariff concession is that it provides an assurance of better market access through improved price competition. Contracting parties negotiate tariff concessions primarily to obtain that advantage. They must therefore be assumed to base their tariff negotiations on the expectation that the price effect of the tariff concessions will not be systematically offset".[702]

The 1992 Follow-up Report of the Members of the Original *EEC - Oilseeds* Panel held that "… the assurance of better market access … would be meaningless" if concessions could be "systematically counteracted".[703]

6.245 The United States further explains that the key question considered by the panel on *EEC - Canned Fruit*, as in all cases involving Article XXIII:1(b), was whether the government measure in question upset the competitive relationship between the domestic and imported product.[704] Likewise, the panel in *EEC - Oilseeds* noted:

> "In the past, Article XXIII:1(b) cases, the CONTRACTING PARTIES have adopted the same approach: their findings of nullification or impairment were based on a finding that the products for which a tariff concession had been granted were subjected to an adverse change in competitive conditions".[705]

6.246 Article 26.1(a) of the DSU states that the complaining party must provide a "detailed justification in support of any complaint". **Japan** emphasizes that, while Article 3.8 of the DSU states that in violation cases, "there is normally a presumption that a breach of the rules has an adverse impact on other Members", there is no presumption of adverse impact in non-violation cases. Therefore, in Japan's view, a complaining party must meet its burden of proof by showing that a measure is currently upsetting the competitive position of the imported product concerned.[706]

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[702]Panel Report on *EEC - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal Feed Proteins ("EEC - Oilseeds")*, BISD 37S/86, 128-129, para. 148. (Emphasis added).

[703]*Follow-up on the Panel Report "EEC - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal Feed Proteins*", 16 March 1992, BISD 39S/91, 116, para. 81, (unadopted).

[704]Panel Report on *European Economic Community - Production Aids Granted on Canned Peaches, Canned Pears, Canned Fruit Cocktails and Dried Grapes ("EEC - Canned Fruit*"), GATT Doc. L/5778, 20 February 1985, (unadopted), p. 29, para. 80.

[705]*EEC - Oilseeds*, BISD 37S/86, 129-130, para. 150.

[706]Ibid.

6.247 Japan argues that all previous non-violation findings have addressed only two specific types of measures: product-specific subsidies and tariffs. In those situations, it was unquestionable that the provision of a subsidy on the domestic product, or a tariff concession on some products, established less favourable competitive conditions for imports of the product concerned. Thus, in all prior panel decisions which found non-violation nullification or impairment, the complaining party showed a clear connection between the alleged measures and the competitive position of imported products.

6.248 Japan points out that the US non-violation claims in this case, however, challenge Japanese policies, e.g., encouraging modernization of distribution practices, regulation of large scale retailing, and regulation of unfair trade practices, which make no distinctions between imports and domestic products. In Japan's view, there is therefore no explicit connection between these alleged measures and the competitive position of imports.

6.249 The **United States** explains that in both the *EEC - Oilseeds* and *EEC - Canned Fruit* cases, the measures applied were subsidies that gave an advantage to domestic products and effectively offset the benefits of the tariff reductions. In the present case, however, Japan has achieved the same objective by application of different measures. Japan systematically sought to offset the effects of its tariff concessions by precluding access to key distribution channels through systemization, and then buttressing the market structure, established through systemization, by application of the Large Stores Law and promotion countermeasures. As tariffs were reduced, Japan placed additional hurdles in the path of imports (e.g., closing distribution channels) to make it substantially more difficult to distribute and sell imported products in Japan. The United States alleges that in taking these actions, Japan has effectively crippled efforts by foreign firms to utilize the opportunity provided by tariff reductions to improve their position in the Japanese market.

6.250 **Japan** responds that none of the alleged measures in dispute is currently upsetting the competitive position of imported black and white or colour film or paper relative to the time of any of the tariff concessions cited by the United States. Japan explains that this conclusion can be demonstrated with respect to each of the three sets of policies in dispute in three different ways:

(1) the alleged measures in dispute do not distinguish between domestic and imported products, and impose no inherent disadvantage on imports;
(2) there is no causal connection between the alleged measures and any unfavourable competitive conditions; and
(3) the alleged measures as they exist today are unchanged or more favourable to imports as compared to the time of any relevant tariff concession.

6.251 In the view of the **United States**, Japan has fabricated three rules as defense against the US claim that the liberalization countermeasures are responsible for the adverse competitive conditions confronting imported film and paper which, in the US view, cannot be substantiated with the text or negotiating history of Article XXIII, or with prior panel decisions:

(1) the Panel may look only at the face of the measures to determine if a tariff concession is being nullified or impaired;
(2) the measures on their face must "formally distinguish" between imported and domestic film and paper or otherwise "inherently disadvantage" imports to nullify or impair the relevant tariff concessions; and
(3) the measures must be more unfavourable to imports today than at any point in the past to nullify or impair a concession.

(a) Measures, trade effects and market structure

6.252 **Japan** argues that in determining whether a benefit is being nullified or impaired, panels should focus exclusively on the measures themselves. Changes in marketplace conditions and trade flows alone, i.e., apart from changes in the measures themselves, in Japan's view, are irrelevant to whether competitive conditions are being upset. Japan submits that the panel report on *EEC - Oilseeds* makes this point unequivocally:

> "The approach of the CONTRACTING PARTIES reflects the fact that governments can often not predict with precision what the impact of their interventions on import volumes will be. If a finding of nullification or impairment depended not only on whether an adverse change in competitive conditions took place but also on whether that change resulted in a decline in imports, the exposure of the contracting parties to claims under Article XXIII:1(b) would depend on factors they do not control; the rules on nullification and impairment could consequently no longer guide government policies … . The Panel further noted that changes in trade volumes result not only from government policies but also other factors, and that, in most circumstances, it is not possible to determine whether a decline in imports following a change in policies is attributable to that change or to other factors".[707]

6.253 In view of the findings of the panel on *EEC - Oilseeds*,[708] **Japan** argues that the relevant consideration in the context of non-violation complaints is whether the alleged measures, not the market situation, have established, and continue to establish, conditions of competition that are less favourable for imported products. Given that Article 26.1(a) of the DSU refers to "any complaint relating to a measure", and that Article 26:1(b) of the DSU states, "where a measure has been found to nullify or impair benefits", Japan concludes that Article 26 of the DSU supports its position.

6.254 The **United States** responds that Japan tries to impose unjustifiable limitations on the facts and circumstances that the Panel can examine in deciding whether there is nullification or impairment of a benefit under GATT. The United States points out that panels typically have found that the complaining party need not present evidence of declining trade flows (e.g., decreases in imports or market share) to prevail on its claim.[709] In this context, the United States refers to the panel report on *EEC - Canned Fruit*[710] which noted that "benefits accruing from bound tariffs under Article II also encompass future trading opportunities" so that "complaints by contracting parties regarding nullification and impairment should be admissible even if there was not yet statistical evidence of trade damage". The United States further argues that the responding party cannot defeat a claim by presenting evidence of the complaining party's improving trade flows (e.g., increases in imports or market share). The *EEC - Oilseeds* panel rejected the EC's "defense" that the subsidies on oilseeds did not displace or impede imports and therefore did not actually nullify or impair the tariff concessions on oilseeds.[711] This is so because panels have generally understood GATT to protect competitive opportunities, not only trade flows, as explained by the panel on *EEC - Oilseeds*:

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[707]*EEC - Oilseeds*, BISD 37S/86, 130-131, para. 151.

[708]"The Panel further noted that changes in trade volumes result not only from government policies but also other factors, and that, in most circumstances, it is not possible to determine whether a decline in imports following a change in policies is attributable to that change or to other factors". *EEC - Oilseeds*, BISD 37S/86, 130-131, para. 151.

[709]The United States also notes that Japan acknowledged that: "[W]hether or not the governmental (dis)incentives, actions or interventions achieved the desired objective in itself is irrelevant in the analysis of a non-violation claim, because what the claim should be concerned with is the impact on the conditions of competition by a government measure, and not the actual results of a governmental action".

[710]*EEC - Canned Fruit*, GATT Doc. L/5778, p. 28, para. 77.

[711]*EEC - Oilseeds*, BISD 37S/86, 129-131, paras. 150-151.

> "In the past Article XXIII:1(b) cases, the CONTRACTING PARTIES have adopted the same approach: their findings of nullification or impairment were based on a finding that the products for which a tariff concession had been granted were subjected to an adverse change in competitive conditions. In none of these cases did they consider the trade impact of the change in competitive conditions to be determining. In one case they specifically rejected the relevance of statistics on trade flows for a finding on nullification and impairment. [Citation omitted]. It is of course true that, in the tariff negotiations in the framework of GATT, contracting parties seek tariff concessions in the hope of expanding their exports, but the commitments they exchange in such negotiations are commitments on conditions of competition for trade, not on volumes of trade".[712]

6.255 The United States points out that panels have applied the same logic in Article III cases, generally in response to the responding party's attempt to use trade flows as a means of defending its measures, not in response to the complaining party's presentation of its claims. In this context, the United States emphasizes that the panel on *United States - Section 337* rejected the US "defense" that the panel's determination "could only be made on the basis of an examination of the actual results of past Section 337 cases".[713]

6.256 The United States further argues that prior panel reports support the proposition that complaining parties may submit, and panels should consider, information on market structure and market conditions.[714] The panel on *Australia - Ammonium Sulphate* would not have known that the termination of the subsidy for Chilean fertilizer would have upset the conditions of competition between Chilean and Australian fertilizers if it had not looked beyond the face of the terminated subsidy program to understand how the two products actually competed in the marketplace.[715]

6.257 Thus the United States stresses that panels should examine the design, architecture, and structure of the measures at issue[716] and focus on the market structure and conditions at the time Japan implemented the various measures to understand the effect of the measures on competitive opportunities for imports *versus* domestic photographic film and paper. Furthermore, panels should examine the market structure and conditions today for confirmation that the measures have had and continue to have an adverse effect on the competitive opportunities for imported film and paper.

6.258 Accordingly, the United States requests the Panel to reject Japan's rule that it (i) must limit its inquiry to the face of the measures in determining whether a tariff concession is being nullified or impaired; and (ii) cannot consider evidence of "marketplace conditions" or "trade flows". The United States explains that some measures may be blatantly protectionist or discriminatory that a panel only

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[712]Ibid.

[713]Panel Report on *United States - Section 337 of the Tariff Act of 1930 ("United States - Section 337"*), adopted on 7 November 1989, BISD 36S/345, 386-387, paras. 5.12-5.13.

[714]The United States notes that there is one case which focused on the panel's treatment of the trade flow data presented by the complaining party as part of its affirmative case - versus trade flow data presented by the responding party in its defense. In *United States - Automobile Taxes*, the EC presented trade flow data to prove that the United States had drawn a distinction between automobiles on the basis of selling price so as to afford protection to domestic production. That panel considered the data and determined they were not conclusive, thereby supporting the US position in this case that this Panel may consider all relevant facts and factors, including evidence related to trade flows. See *United States - Taxes on Automobiles*, GATT Doc. DS 31/R, p. 101, para. 5.13.

[715]*Report of the Working Party on the Australian Subsidy on Ammonium Sulphate ("Australia - Ammonium Sulphate"),* BISD II/188, 192-193, para. 12. See also *Japan - Taxes on Alcoholic Beverages ("Japan - Alcoholic Beverages"),* WT/DS8/R, pp. 113, 116-119, paras. 6.23, 6.29-6.32 (considering evidence outside the four corners of the tax measures at issue to determine if differently taxed products are like products or directly competitive or substitutable products).

[716]See Appellate Body Report on *Japan - Taxes on Alcoholic Beverages ("Japan - Alcoholic Beverages"),* WT/DS8, 10 and 11/AB/R, p. 29.

needs to look within the four corners of the measure to understand its protective effect.[717] But, for many measures, the United States submits, a panel cannot determine whether the measure is affecting the competitive opportunities for imported products if it does not have some understanding of the market structure and conditions in which the imports are being sold.[718]

6.259 **Japan** argues that the existing marketplace conditions or trade flows result from various factors, such as market forces and private practices, and are beyond the control of the government. Determining the nullification or impairment of the benefit by inference from the marketplace conditions or trade flows, which allegedly demonstrates actual trade damage, could lead to the consequence that a government would be held responsible for what it does not control. In Japan's view, therefore, the panel must focus on the measures themselves, and not on the marketplace conditions or trade flows.

6.260 According to Japan, in evaluating the upsetting of competitive conditions allegedly caused by measures, panels thus must look exclusively to the provisions of the measures themselves, and whether they are inherently less favourable to imports of the bound product than to domestic products. The panel should not be misled by incidental consequences, i.e., in this case, the allegedly "closed" distribution networks in the Japanese film and paper markets today.

6.261 Japan submits that the principle that measures should be judged by their provisions, and not by their actual consequences, is well established in Article III jurisprudence where the competitive conditions established by measures are similarly at issue. The panel report on *United States - Section 337 of the Tariff Act of 1930* found that panels should base their Article III analysis "on the distinctions made by the laws, regulations, or requirements themselves and on their potential impact, rather than on the actual consequences for specific imported products".[719]

6.262 Japan also mentions the unadopted panel report on *United States - Taxes on Automobiles*,[720] which dealt with the issue of whether measures altered the competitive relationship between imported and domestic products. In that case, the United States imposed a luxury tax on all automobiles priced over $30,000. The EC argued that this tax, while facially neutral, discriminated against European cars in violation of Article III:2, given that a large percentage of the cars imported from the EC were priced over $30,000 while many US cars were priced under $30,000. The panel rejected this argument on the ground that the distinction drawn between automobiles priced under and above $30,000 was not inherently disadvantageous to European imports and concluded that the US measure did not discriminate automobiles from the EC in violation of Article III:2.[721]

6.263 The **United States** rejects the notion that a measure cannot nullify or impair benefits unless it: (i) draws "formal distinctions" between imported and domestic products; or (ii) is otherwise "inherently less favourable" to imports. The United States submits that in proposing and applying this rule, Japan refers to a number of terms such as "formal distinctions", "distinguishes between", "explicit disadvantage", "inherently less favourable", "inherently disadvantageous", and "inherently

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[717]In *EEC - Oilseeds*, for example, the panel appears to have limited its consideration of whether the subsidies at issue upset the competitive relationship between imported and domestic products by looking exclusively at the face of the measure. *EEC - Oilseeds*, BISD 37S/86, 128, para. 147.

[718]See, e.g., *Australia - Ammonium Sulphate*, BISD II/188, 192-193, para. 12. The United States explains that, for example, a measure applied in the oligopolistic photographic materials sector in Japan could have an entirely different effect if applied for example, in the highly competitive textiles sector in Hong Kong. Only by reviewing the measure in the context of the market in which it is applied can the effect of some measures on competitive opportunities be understood.

[719]Panel Report on *United States - Section 337*, BISD 36S/345, 387, para. 5.13.

[720]Panel Report on *United States - Taxes on Automobiles*, GATT Doc. DS31/R, 11 October 1994 (unadopted).

[721]"[A] selling price above $30,000 did not appear from the evidence to be inherent to the EC or other foreign automobiles. In particular, no evidence had been advanced that EC or other foreign automobile manufacturers did not in general have the design, production, and marketing capabilities to sell automobiles below the $30,000 threshold, or that they did not in general produce such models for other markets". Ibid., p. 102, para. 5.14.

unfavourable", without defining the meaning of these terms, except through a reference to the panel report in *United States - Automobile Taxes*. The United States suggests that Japan mischaracterizes the *Automobile Taxes* report as standing for the proposition that a measure cannot violate Article III:2 if it is "not inherently disadvantageous to imports". In the view of the United States, that panel found that the taxes at issue did not discriminate against foreign automobiles because neither the aim, effect, nor any other evidence showed that the measure afforded protection to domestic production.[722]

6.264 In the US understanding, Japan appears to be arguing that only measures which obviously discriminate against imported products can nullify or impair tariff concessions within the meaning of Article XXIII:1(b). While Japan substantiates its interpretation with an analogy to Article III, the United States contends that Japan's interpretation has not even been applied in the Article III context. The United States points out that panels have found that laws, regulations, and requirements that do not discriminate against products on the basis of origin nevertheless can violate Article III.[723] Panels also have affirmed that a measure which does not draw any formal distinctions between imported and domestic products on the basis of origin or other product characteristics can violate Article III.[724] More importantly, the United States emphasizes that if this rule were applied under Article XXIII:1(b), that Article would become redundant, thereby effectively eliminating a Member's right of redress for non-violation nullification and impairment. Such an outcome would not only be inconsistent with the general rules of treaty interpretation,[725] but would also be inconsistent with the plain language of Article XXIII:1(b), which provides a right of redress if a benefit under the GATT is being nullified or impaired as a result of any measure "whether or not it conflicts with the provisions" of the GATT.

6.265 In response to the United States claim that Japan's position is not valid because it would render Article XXIII:1(b) a legal nullity, **Japan** argues that the United States bases this argument on the view that all inherently discriminatory measures may be addressed under Article III. In Japan's view, however, not all cases of inherent discrimination can be considered to be in violation of Article III. For example, production subsidies which are potentially discriminatory are specifically excluded by Article III:8(b) from the scope of Article III and Article XXIII:1(b) could also deal with non-mandatory government measures if it imposes a substantive equivalent of legally binding obligations, whereas Article III:4 only covers laws, regulations, and requirements and has a narrower scope.

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[722]Ibid., pp. 100-102, paras. 5.12-5.14.

[723]See, e.g., Panel Report on *Japan - Alcoholic Beverages*, WT/DS8, 10 and 11/R (finding that Japanese tax measures that differentiated between spirits by product characteristics violated Article III:2); Panel Report on *United States - Measures Affecting Alcoholic and Malt Beverages ("United States - Alcoholic Beverages")*, adopted on 19 June 1992, BISD 39S/206, 277, para. 5.26 (finding that a Mississippi tax that differentiated between wines by grape type violated Article III:2).

[724]See, e.g., Panel Report on *United States - Section 337*, BISD 36S/345, 386, para. 5.11 (noting that it "has to be recognized that there may be cases where application of formally identical legal provisions would in practice accord less favourable treatment to imported products"); Panel Report on *Canada - Import, Distribution, and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, adopted 18 February 1992, BISD 39S/27, 83, para. 5.27 (finding that "minimum prices applied equally to imported and domestic beer did not necessarily accord equal conditions of competition to imported and domestic beer"); Panel Report on *Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes* (*"Thailand - Importation of Cigarettes*"), adopted 7 November 1990, BISD 37S/200, 224, para. 78 (noting that "It might be argued that… a general ban on all cigarette advertising would create unequal competitive opportunities between the existing Thai supplier of cigarettes and new, foreign suppliers"); *United States - Alcoholic Beverages*, BISD 39S/206, 275, para. 5.19 (finding that "the granting of tax credits on a non-discriminatory basis to small breweries inside and outside the United States' would be inconsistent with Article III:2 as long as imported beer from large breweries were subject to higher taxes"). See also Article XVII of GATS (providing that "formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of any other Member").

[725]The Appellate Body has noted on two occasions that "[o]ne of the corollaries of the 'general rule of interpretation' in set out in Article 31 of the VCLT is that interpreter must give meaning and effect to all terms of the treaty. An interpretation is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility. Appellate Body Report, *Japan - Alcoholic Beverages*, pp. 11-12, (citing Appellate Body report, *United States - Standard for Conventional and Reformulated Gasoline*).

6.266 Japan further argues that the complaining party must show that the benefit "is being" nullified or impaired by the measure. Japan emphasizes that many of the alleged "measures" complained against ended years ago. However, a measure which is no longer in effect cannot currently be establishing less favourable conditions of competition for imports of the bound product, and therefore cannot result in nullification or impairment. On the other hand, Japan concedes that there are some "measures" identified by the United States that are still in effect. However, in Japan's view, those alleged measures cannot upset the competitive position of imported film and paper because a measure that does not "apply" to the given product as such, is incapable of upsetting competitive conditions for imports of that product.

6.267 The **United States** notes that it concurs with Japan on the proposition that a finding of nonviolation nullification and impairment may be based only on measures that are currently in force. The United States does not believe, however, that Japan has presented credible evidence that its intervention in photographic material distribution is merely "a fact of the past".

(b) Causal connection

6.268 **Japan** argues that even if the panel looks beyond the provisions of the measure in question and examines actual consequences, at the very least the complaining party must be required to prove a clear causal connection between the alleged measures and competitive conditions unfavourable to imports. Japan explains that this requirement is reflected in the phrase "as the result of" as stipulated in Article XXIII:1. In particular, in Japan's view, the complaining party must not only establish (1) that conditions are in fact unfavourable to imports, but also (2) that those conditions are due to the alleged measures in question. Otherwise, Japan contends, if no causal connection between the measures and unfavourable competitive conditions is established, any non-violation finding would rest simply on changes in marketplace conditions alone, a result squarely at odds with the relevant provisions of the WTO Agreement and with past precedent.

6.269 The **United States** responds that it does not take issue with the proposition that there must be a causal connection between the measures and the competitive conditions complained of. However, to the United States, it appears that Japan is advocating a requirement that the complaining party must establish causation in a "but for" sense; i.e., that the United States must establish that the unfavourable competitive conditions in Japan for imported photographic film and paper were solely the result of the measures taken by Japan and that "but for" these measures, these conditions would not exist. To the extent that this is the causation standard advocated by Japan, the United States strongly disagrees.

6.270 According to the United States, Japan cites the phrase "as the result of" in Article XXIII:1, in support of a "but for" causation standard. The United States contends that textual interpretation of this phrase does not support such a strict standard of causation. In the US view, if the drafters had intended such a standard, they would have inserted a word like "directly" or "solely" immediately before the phrase "as the result of".[726] A "but for" causation standard is also inconsistent with the object and purpose of Article XXIII:1(b). The drafters clearly intended that Article XXIII:1(b) be capable of providing relief in appropriate circumstances. However, under a "but for" causation standard, the United States submits, a complaining party essentially would face the impossible task of proving the negative, e.g., in this case, that the documented unfavourable market conditions for imported photographic film and paper would not have existed "but for" the actions of the Japanese Government. The United States asserts that such an approach would render Article XXIII:1(b) a deadletter, a result at odds with the intent of the drafters. In this regard, the United States recalls that the Appellate Body has cautioned against reading into provisions of WTO agreements requirements that are not reflected

[726]The United States notes that in Article 8.2(a)(iv) and (v) of the SCM Agreement, the drafters used the phrase "directly as the result of" to refer to the types of costs that could be covered by non-actionable government assistance for research activities. Thus, the United States argues that when the drafters intended a strict causation standard, they knew how to express their intentions.

in the text of those provisions. For example, in the *United States - Underwear*[727] and the *United States - Wool Shirts*[728] cases, the Appellate Body stressed the importance of respecting the balance of rights and obligations as reflected in the actual language used by the drafters.

6.271 The United States warns that the establishment of a "but for" causation standard would amount to rewriting Article XXIII:1(b). Accordingly, the United States claims to have established what it is required to establish under Article XXIII:1(b), i.e., that (i) Japan sought to alter the conditions of competition for the distribution and sale of photographic film in Japan; and (ii) those conditions have been altered.

6.272 The United States further contends that rather than apply a but-for causation standard, the Panel should determine whether Japan took measures that affirmatively contributed to the formation, strengthening, and maintenance of conditions of the oligopolistic distribution structure in Japan. Japan did so through a series of actions promoting exclusive dealings between Japanese manufacturers and wholesalers, cementing such relationships where they already existed, pushing those exclusive relationships as far downstream as possible, and defending them against competition from foreign firms and alternative distribution channels. Specifically, Japan pursued these ends through measures that:

1. shifted the balance of economic power between manufacturers and wholesalers (through shortened payment terms);

2. created an incentive for volume purchasing and channel exclusivity (through volume discounts, rebates);

3. chilled foreign firms' ability to offer more competitive terms to wholesalers (through standardized transaction terms, international contract notification, JFTC Notification 17 and the comparable underlying provisions of the Antimonopoly Law);

4. enhanced domestic manufacturers' integration with, and control over, wholesalers (through electronic information link, joint distribution facilities);

5. limited the availability of alternative distribution channels to foreign firms (through subsidies to laboratories, Large Stores Law);

6. curtailed competition to manufacturer domination of the distribution structure by suppressing large stores (through the Large Stores Law); and

7. stifled foreign manufacturers' ability to utilize their strengths in promoting their products (through the promotion countermeasures).

With the support of these measures: Fuji achieved exclusive control of its four primary wholesalers; Konica solidified its relationships with its previously independent primary wholesalers, first through establishing joint distribution facilities with them and then by acquiring them outright; secondary wholesalers became aligned with the domestic manufacturers' vertical distribution chains; and Fuji

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[727]In the *Underwear* case, the Appellate Body declined to read into Article 6.10 of the Agreement on Textiles and Clothing a license to backdate the effective date of a temporary restraint measure. The Appellate Body previously has relied on a comparison of the texts of different WTO agreements in order to elucidate the meaning of a particular provision. Appellate Body Report on *United States - Restrictions on Imports of Cotton and Man-made Fibre Underwear*, adopted 25 February 1997, WT/DS24/AB/R, p. 17, n. 25.

[728]In the *Wool Shirts* case, the Appellate Body declined to read into the Agreement on Textiles and Clothing a requirement that the importing Member bear the burden of proving that temporary safeguard action was not inconsistent with Article 6 of the Agreement on Textiles and Clothing. Appellate Body Report on *United States - Measures Affecting Imports of Woven Wool Shirts from India*, adopted on 23 May 1997, WT/DS33/AB/R.

gained domination over a vast network of photo processing laboratories, substantially limiting their availability as an alternative distribution channel for foreign film and as a market for foreign photographic paper. These measures also significantly impaired the ability of foreign manufacturers to overcome the obstacles of the oligopolistic distribution system by offering competitive incentives to wholesalers or consumers or by-passing wholesalers to go directly to large stores. Each of these actions and results is significant in itself. But together, they combine to substantially alter the conditions of competition in ways that are adverse to imports.

6.273 **Japan** responds that the United States appears to argue that causation can be established by showing the existence of government measures on one hand, and the existence of unfavourable market conditions on the other hand, without proving the linkage between them. Although Japan does not argue that it is necessary for a complaining party to show that the unfavourable competitive conditions were "solely" the result of the alleged measure, Japan considers it indispensable to prove a clear linkage between the alleged measures themselves and the alleged unfavourable competitive conditions with "detailed justification". In Japan's view, the existing marketplace conditions result from various factors such as market forces and private practices. Determining the nullification or impairment of the benefit by inference from the marketplace conditions could lead to the consequence that a government would be held responsible for what is does not control.

(c) Relevance of the time of the tariff concession

6.274 Japan emphasizes that in order to demonstrate current nullification or impairment, it is necessary to compare the measure in question as it exists today with the measure (or absence thereof) as it existed at the time of the relevant tariff concession. If a measure at present is not materially changed, or is now more favourable to the imports, as compared to the time of the relevant tariff concession, there can be no upsetting of the competitive position.[729] For Japan, it is irrelevant whether marketplace conditions have worsened in that interim period.

6.275 In the view of the **United States**, there is no legal basis for Japan's position that a measure which continues to exist in its original or a modified form cannot nullify or impair tariff concession. The United States explains that the fact that a measure may have been upsetting the competitive relationship between imported and domestic products for some period of time does not mean that the measure suddenly ceases to have that effect. Similarly, the fact that a measure may be "liberalized" does not mean that it no longer upsets the competitive relationship between imported and domestic products. For example, if a Member began providing a subsidy in 1979, the subsidy could still be nullifying or impairing tariff concessions on the subsidized products ten years later. Similarly, if a Member began providing a subsidy in 1979 and then cut in half the amount of the subsidy to the recipient ten years later, the subsidy could still be nullifying or impairing tariff concessions on the subsidized products.

6.276 **Japan** responds that unlike Article III of GATT 1994, the tariff concessions under Article II of the GATT 1994 do not establish equal competitive conditions between domestic and imported products, since a tariff is by its nature a barrier to imported products. For the purpose of a non-violation remedy, therefore, the benefit of the tariff concessions accruing under Article II consists of the legitimate expectation that competitive conditions for imported products had improved compared to the competitive conditions that existed before the tariff concessions. In Japan's view, this analysis is in line with the finding of the *EEC - Oilseeds* panel, which stated that, "[i]n the past Article XXIII:1(b) cases, the contracting parties have adopted the same approach: their findings of nullification or impairment were

[729]The *EEC - Oilseeds* panel found that: "In the past Article XXIII:1(b) cases, the CONTRACTING PARTIES have adopted the same approach: their findings of nullification or impairment were based on a finding that the products for which a tariff concession had been granted were subjected to an adverse change in competitive conditions". *EEC - Oilseeds*, BISD 37S/86, 129-130, para. 150.

based on a finding that the products for which a tariff concession had been granted were subjected to *an adverse change in competitive conditions"*.[730]

2. OVERVIEW OF THE IMPACT OF SPECIFIC MEASURES ON THE COMPETITIVE POSITION OF IMPORTS

6.277 According to the **United States**, on 6 June 1967, as the Kennedy Round was concluding, the Japanese Cabinet announced that it would apply "countermeasures" to "create the foundation to enable our enterprises to compete with foreign enterprises on equal terms. …".[731] For the United States, the purpose of the countermeasures was not to ensure that foreign enterprises had equal opportunities to compete with Japanese enterprises in Japan. In the US view, Japan sought to "restrain foreign enterprises coming into Japan after liberalization from disturbing order in domestic industries concerned by resorting to the strength of their superior power and from advancing into the non-liberalized sectors by evading control".[732] The United States concludes that the very premise of the Japanese Government's countermeasures was to upset the competitive relationship between domestic and foreign enterprises by neutralizing the perceived advantages of foreign enterprises of their superior capital resources, organizational scale, and marketing expertise.[733]

6.278 The United States claims that the Japanese Government designed measures to neutralize the advantages of foreign enterprises arising from the tariff concessions, working closely with the Japanese industry to give effect to the closing of the Japanese market:

(i) MITI and other Japanese Government agencies implemented distribution countermeasures to limit foreign penetration of the Japanese market through Japanese wholesalers and retailers;
(ii) MITI implemented the Large Store Law, in part, to control the growth of large stores which would promote the sale of imported products; and
(iii) the JFTC implemented promotional countermeasures to make it more difficult for foreign enterprises to attract Japanese consumers to imported products.

6.279 During the Tokyo Round, US negotiators once again attached a high priority to obtaining from Japan tariff concessions on both black and white, and colour photographic film and paper.[734] The United States argues that, having closed the primary distribution network, limited the operation of large-scale retail stores and imposed a panoply of restraints on promotions following the Kennedy Round, nonetheless, following the Tokyo Round, Japan imposed further burdens on large stores and marketing activities.

6.280 The United States further submits that in the Uruguay Round, Japan entered into a zero binding on colour photographic film and paper.[735] During the Uruguay Round negotiations, Japan's trading partners knew that the Japanese market was difficult to penetrate, but the way in which the distribution countermeasures, Large Stores Law, and promotion countermeasures worked in concert to systematically

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[730]*EEC - Oilseeds*, pp. 129-130, para. 150 (emphasis added).

[731]1967 Cabinet Decision, p. 3-4. US Ex. 67-6.

[732]Ibid., p. 4.

[733]The United States notes that the Distribution Committee in its Sixth Interim Report explained that Japanese enterprises were inferior to their American counterparts on the basis of capital resources, organizational scale (as measured by the number of employees, number of stores, sales volume, and net profit), and sales technique. Sixth Interim Report, p. 29, US Ex. 68-8.

[734]Given that colour film and paper had replaced black and white film and paper as the majority consumer product in 1971 and the predominant consumer product in 1975, US negotiators sought and received even deeper cuts in the tariff rates for colour film and paper products (4 percent on each) than for black and white film and paper products (7.2 percent and 6.6 percent, respectively).

[735]The United States sought full market access in Japan and achieved tariff bindings to ensure that such market access would continue, notwithstanding that Japan had maintained an applied rate of zero since 1990.

offset tariff concessions on photographic film and paper was not known. This web of liberalization countermeasures has continued to operate to nullify or impair US benefits, due to: (i) foreclosure from the primary wholesale channels of distribution as a result of the distribution countermeasures; (ii) sharp diminution of alternative channels, i.e., large stores, and secondary wholesalers; and (iii) inability to price and promote products effectively and competitively as a result of restrictions under the Premiums Law and Antimonopoly Law.

6.281 According to the United States, Japan achieved this result through several measures:

6.282 First, the United States submits that Japan promoted and implemented standardized transaction terms between manufacturers and wholesalers, and between primary wholesalers and secondary wholesalers and retailers. These transaction terms fostered exclusive dealing between Japanese manufacturers, wholesalers, and retailers of photographic film and paper. Where such exclusive relationships already existed, the terms promoted by the Japanese Government further cemented the relationships. In addition, the standardization of transaction terms among manufacturers and among wholesalers limited the ability of foreign manufacturers to attract wholesalers with more competitive transaction terms. Each contract between a foreign manufacturer and Japanese distributor was subject to automatic scrutiny by the JFTC, and more favourable terms could be considered an unfair trade practice in violation of the Law.

6.283 Second, Japan is alleged to have used administrative guidance and concessionary financing to establish or solidify physical infrastructure and computer ties between Japanese manufacturers and wholesalers. These ties further cemented the closed vertical relationships in the Japanese distribution system, to the exclusion of foreign products.

6.284 Third, the United States argues that Japan used administrative guidance and concessionary financing to limit foreign firms' access to a new distribution channel that began to emerge in the late 1960s and early 1970s, i.e., colour photoprocessing laboratories. Through its subsidized loans, Japan helped ensure that 84 percent of colour laboratories act as captive distributors for Japanese film manufacturers and a captive market for Japanese photographic paper manufacturers.

6.285 Fourth, according to the United States, Japan implemented, amended, and aggressively applied measures to restrict the growth of what Japan's own reports identified as the greatest threat to the oligopolistic distribution structure of domestic manufacturers, i.e., large stores. Not only were large stores a challenge to the oligopolistic distribution structure, they also presented a potentially significant alternative distribution channel for foreign film to by-pass the exclusive wholesale system. In the US view, Japan's strict application of both formal and informal adjustment procedures under the law have very effectively suppressed the growth of large stores in Japan for three decades.

6.286 Fifth, the United States contends that Japan substantially curtailed the ability of foreign firms to ply their capital strength and marketing prowess to attract Japanese distributors and consumers to their products. Japan not only developed strict limits on promotions, it authorized the Japanese private sector to develop and enforce its own, stricter standards, and it allowed these stricter standards to govern the market as a whole.

6.287 According to the United States, the result of these measures is a market structure in which none of the primary wholesalers carries foreign film or paper, whereas Japanese film manufacturers sell all of their product through these wholesalers.[736] The disadvantages to being excluded from the principal distribution channel are manifold given that foreign firms have no prospect of matching or

[736]Among the two foreign manufacturers, Kodak is able to sell only 15 percent of its film through secondary wholesalers and 25 percent through colour laboratories; the remainder it must sell direct to retail. Agfa relies on direct to retail sales for virtually all of its film.

re-creating the infrastructure, geographic reach, relationships with customers, and efficiencies of scope that the primary wholesalers have.[737]

6.288 The United States emphasizes that the distribution countermeasures, Large Stores Law, and promotion countermeasures have played an instrumental role in the establishment and maintenance of the closed, domestic-manufacturer-dominated distribution system for photographic film and paper in Japan. By means of a series of measures, the Japanese Government has contributed to the formation, strengthening, and maintenance of exclusive ties between manufacturers and wholesalers, and between primary wholesalers and secondary wholesalers and retailers. Japan undertook additional measures that have protected this system from competition from foreign suppliers and from the growth of alternative channels, such as large stores and laboratories, for the distribution of imported photographic film and paper. The United States submits that it explains in detail how each of the measures assists in accomplishing these results, including:

(i) shifting the balance of economic power between manufacturers and wholesalers (through shortened payment terms);
(ii) creating an incentive for volume purchasing and "channel exclusivity" (through volume discounts, rebates);
(iii) chilling the ability of foreign firms to offer more competitive terms to wholesalers (through standardized transaction terms, international contract notification, Premiums Law Notification 17 and the comparable underlying provisions of the Antimonopoly Law);
(iv) enhancing domestic manufacturers' integration with, and control over, wholesalers (through electronic information links, joint distribution facilities);
(v) limiting the availability to foreign firms of alternative distribution channels (through subsidies to laboratories, Large Stores Law);
(vi) limiting competition to manufacturer domination of the distribution structure by suppressing large stores (through the Large Stores Law); and
(vii) stifling the ability of foreign manufacturers to utilize their strengths in promoting their products (through the promotion countermeasures).

6.289 The United States claims that it documents not only how these measures helped create the vertically integrated distribution system beginning 30 years ago, but also how they have been instrumental in maintaining it up to the present. In addition, the United States argues that it demonstrates that, as a result of the measures applied by Japan, the conditions of competition for the distribution and sale of photographic film in Japan have been altered to the disadvantage of imported products.

6.290 According to **Japan**, to show that the "measure" in question is upsetting the competitive position of imported products, the following three criteria should be demonstrated:

(1) whether or not the measures themselves, not the marketplace conditions, are upsetting the competitive conditions of the imports;
(2) whether or not the complaining party has demonstrated a clear causal connection between the alleged measures and competitive conditions unfavourable to imports; and

[737]The United States request the Panel to examine how these measures have operated in the market, and how Japanese Government and the private sector have interacted to give the measures effect. The United States emphasizes that government/industry relations and the use of administrative guidance in Japan are unique. According to the United States, the process of "concerted adjustment" involves extensive back-and-forth interaction between industry and government, including surveying of market conditions, coordination to build consensus, government validation of the consensus through announcement of guidance, and constant government monitoring to ensure that the guidance is implemented. While to an outsider the formal policy announcement may not appear particularly binding or forceful, within Japan, however, the pervasive government involvement, monitoring, peer pressure, and potential for additional formal or informal action carries significant force.

(3) whether or not the competitive conditions of the imports are less favoured under the measure in question as it exists today than they were under the measure as it existed at the time of the relevant tariff concessions.

6.291 As for the first point, Japan emphasizes that the alleged measures do not make any distinction between products, either explicitly or implicitly, based on their country of origin, or draw any line at all between products based on any product characteristics. In Japan's view, these features are important indications that the alleged measures do not upset the competitive conditions of imports.

6.292 Regarding the need to demonstrate a casual connection, Japan notes that the existing marketplace conditions or trade flows result from various factors such as market forces and private practices and are beyond the control of the government. Japan explains that determining the nullification or impairment of the benefit by inference from the marketplace conditions or trade flows, which allegedly demonstrates actual trade damage, could lead to the consequence that a government would be held responsible for what it does not control. Therefore, Japan maintains that the legal examination should focus on the measures themselves, and not on the marketplace conditions or trade flows.

6.293 With regard to the third point, Japan emphasizes that unlike Article III of GATT, the tariff concessions under Article II of GATT do not establish equal competitive conditions between domestic and imported products, since a tariff is by its nature a barrier to imported products. For the purpose of a non-violation remedy, therefore, the benefit of the tariff concessions accruing under Article II consists of the legitimate expectation that competitive conditions for imported products had improved compared to the competitive conditions that existed before tariff concessions. In Japan's view, this analysis is consistent with the finding of the panel on *EEC - Oilseeds*, which stated that, "[i]n the past Article XXIII:1(b) cases, the contracting parties have adopted the same approach: their findings of nullification or impairment were based on a finding that the products for which a tariff concession had been granted were subjected to an adverse change in competitive conditions".[738]

3. DISTRIBUTION "COUNTERMEASURES"

6.294 According to the **United States**, at the time Japan began liberalizing tariffs and quantitative restrictions on photographic film and paper, a foreign manufacturer attempting to break into the Japanese distribution system could not invest in a Japanese distributor, could not give prizes, gifts, cash, or other premiums to a Japanese distributor beyond a token amount, and could not offer more competitive transaction terms to a distributor without reporting them to the JFTC and risking Antimonopoly Law action. Even simply price cutting could bring automatic scrutiny under the international contract notification provisions, and raise the risk of a "dumping" or unfair trade practices case under the Antimonopoly Law. Meanwhile, the tightened payment terms, rebates, and volume discounts continued to work - along with other aspects of the "systemization" policy such as information links and physical integration of distribution - to establish and solidify exclusive vertical relationships in the Japanese distribution system for photographic film and paper. These barriers prevented foreign manufacturers from forming or maintaining relationships with Japanese wholesalers that would accord meaningful access to the Japanese market. The continuation of these barriers for nearly three decades has allowed the Japanese manufacturers to maintain domination over the wholesale distribution system, to the near exclusion of foreign suppliers. The factual aspects of these measures are also described in Section B of Part II and, in more detail, in Section A of Part V.

[738] *EEC - Oilseeds*, BISD 37S/86, 129-130, para. 150.

(a) Evolution of systemization, rationalization and standardization of distribution policies

6.295 *1967 Cabinet Decision*: The United States submits that in June 1967, the Japanese Cabinet approved the use of distribution countermeasures[739] to limit foreign enterprises from penetrating the Japanese market through Japanese distributors.[740] To implement this part of the Cabinet's decision, MITI, the JFTC, the Small and Medium Enterprise Agency (SMEA), and the Japan Development Bank (JDB) developed a series of countermeasures that: (1) limited the ability of foreign enterprises to use economic incentives to induce Japanese distributors to carry their products; (2) promoted "systemization" of wholesalers into manufacturer-controlled distribution channels, including through the use of standardized transaction terms which excluded foreign enterprises from the main channels of distribution; and (3) financed the development of these exclusive distribution channels. The US claims that these distribution countermeasures upset the conditions of competition between imported and domestic products following the conclusion of the Kennedy Round.

6.296 *1967 JFTC Notification 17*: In May 1967, the JFTC issued Notification 17 which set a 100,000 yen maximum limit on the premium that a manufacturer could give to a wholesaler or retailer (or a primary wholesaler to a secondary wholesaler or retailer) in one year for all products traded between the two.[741] The United States claims that even though the 100,000 yen restriction applied to both domestic and foreign enterprises, it upset the competitive relationship between the two. Foreign enterprises entering the Japanese market or trying to expand their market share were not able to invest in their own distribution networks, and had to compete with Japanese manufacturers for existing wholesalers and distributors to carry their products. Notification 17 limited the ability of foreign enterprises to "outbid" Japanese enterprises in the competition for Japanese distributors by setting an arbitrarily low ceiling on the amount of premiums that a manufacturer could give to a wholesaler or retailer in any one year. JFTC Notification 17 was applicable only to offers of goods. Low price offers, rebates and offers of goods to assist the other parties' promotional activities were outside the scope of the regulation.

6.297 *1968 Sixth Interim Report*: The United States notes that in August 1968, the MITI Distribution Committee's Sixth Interim Report recommended the "rationalization of transaction terms" as another means of preventing foreign enterprises from penetrating the Japanese market through the distribution system.[742] Specifically, it recommended (i) standardizing transaction terms, (ii) rationalizing physical distribution techniques,[743] and (iii) making improvements in the distribution environment.[744] The goal was to improve the efficiency and, more importantly, to give control of the distribution channels in Japan to domestic manufacturers.[745] In 1969, MITI's Transaction Terms Standardization Committee was formed to develop sector-specific transaction terms for eleven products, including film.

6.298 *1969 Seventh Interim Report*: The United States submits that MITI Distribution Committee's Seventh Interim Report noted that "the concerted efforts of government and the private sector must be directed at systemization from the point of view of a capital liberalization countermeasure."[746] It recommended (i) establishing a "Distribution Systemization Promotion Council" comprised of scholars, manufacturers, wholesalers, retailers, and computer specialists, to establish consensus on the basic direction for systematizing distribution activities; (ii) researching and promoting distribution

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[739]Japan strongly disagrees with the US phrase "distribution countermeasures." See translation issue 1.

[740]1967 Cabinet Decision, p. 6. US Ex. 67-6.

[741]JFTC Notification 17, 20 May 1967, p. 1, US Ex. 67-4.

[742]Industrial Structure Deliberation Council - Distribution Modernization Outlook and Issues, 27 July 1968 (Sixth Interim Report), p. 39, US Ex. 68-8.

[743]Sixth Interim Report, p. 33, US Ex. 68-8.

[744]Ibid. p. 33.

[745]Ibid., p. 36.

[746]Distribution Systemization - Industrial Structure Council Distribution Committee, 22 July 1969 (Seventh Interim Report 1969), p. 46, US Ex. 69-4.

systemization; and (iii) providing financial incentives through loans or special tax treatment to support systemization.[747]

6.299 *1970 Guidelines on Transaction Terms*: In 1970, MITI issued "Guidelines for Standardizing Terms of Trade for Photographic Film," establishing industry standards for, e.g., sales contracts; discounts; rebates; frequency of, and minimum order per, delivery; return of goods; terms of payment, and dispatched employees.[748] The United States alleges that the application of the 1970 Guidelines upset the competitive relationship between imported and domestic photographic materials in several ways as discussed in detail below.[749]

6.300 *1971 International Contract Notification*: The United States argues that the 1971 "Rules on Filing Notification of International Agreements on Contracts"[750] require each contract between a foreign manufacturer and a Japanese wholesaler to be reported to the JFTC. This notification requirement enables the JFTC to see if the foreign manufacturer is offering more competitive transaction terms departing from the industry standard, and if so, to consider action under the Antimonopoly Law.

6.301 *1971 Basic Plan for Distribution Systemization*: The United States submits that MITI's Distribution Systemization Promotion Council[751] issued a "Basic Plan for Distribution Systemization" in July 1971. That plan announced that modernization of the Japanese distribution sector was urgent from the standpoint of capital liberalization countermeasures,[752] explained that the entire distribution process should be regarded as a single system, and instructed individual industries to use rational transaction conditions to prevent disruption by foreign capitalized firms.[753]

6.302 *1975 Manual for Systemization of Camera and Film Distribution*: The United States points out that MITI's Distribution Systemization Development Centre, established in 1972, pursuant to the 1971 Basic Plan, issued the "Manual for the Systemization of Camera and Film Distribution" in 1975.[754] It stressed the need to protect against foreign manufacturers gaining market shares for imported products by consolidating producer-distributor linkages that would improve Japanese manufacturers' capacity to resist the foreign capital-affiliated corporations.[755] Specifically, the Manual (i) advised businesses to maintain "appropriate prices" and proper discount and rebate margins, to rationalize payment terms, and to improve order and delivery systems; (ii) recommended that the camera and film industries improve their information systems to facilitate communication among firms and to improve access to important business information; and (iii) called for establishing an industry association and a government-affiliated committee which recommended systemization projects for government funding.

6.303 According to the United States, during the Uruguay Round negotiations, Japan's trading partners producing photographic materials knew that the Japanese market was difficult to penetrate, but the way in which the distribution countermeasures, Large Stores Law, and promotion countermeasures

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[747]Ibid., p. 54, US Ex. 69-4. The Distribution Committee Ninth Interim Report described the Seventh Interim Report as "a powerful political blueprint for reforming the distribution sector". Industrial Structure Deliberation Council - Distribution for the 1970s (Ninth Interim Report), 22 July 1971, US Ex. 71-9.

[748]For a more detailed description of the 1970 Guidelines, see Part II.B.2.(c), Part V.A.5.(b), and US Ex. 70-4.

[749]See, inter alia, sub-sections (b-d) of this Part VI.D.3.

[750]JFTC, Rule Regarding International Agreement on International Contract Notification, Rule No. 1, 12 April 1971, US Ex. 71-6.

[751]The Council was established as a result of the recommendations of the Seventh Interim Report in September 1970.

[752]The Basic Plan, p. 2, US Ex. 71-10.

[753]Ibid, p. 10.

[754]MITI, Manual for Systemization of Camera and Film Distribution, March 1975, p. 2-15, 43 ("1975 Manual"), US Ex. 75-5.

[755]The Manual described the changes in the industry since the early 1960's which paralleled the changes that the Japanese Government had promoted through various policy documents between 1967 and 1975, e.g., distributors began to pay their balances monthly and, in most instances, no longer carried competing products.

worked in concert to systematically offset tariff concessions was not known. In the US view, this web of liberalization countermeasures has continued to operate to nullify or impair US benefits accruing not only from the Uruguay Round, but the Tokyo and Kennedy rounds as well.

(b) Objectives underlying the introduction of transaction terms

6.304 According to the **United States**, Japan 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. For the US, Japan specifically sought to neutralize a competitive advantage of imports and to prevent foreign distributors from acquiring Japanese distributors, and move upstream into manufacturing and downstream into retailing.[756] In the US view, Japan's restructuring of the distribution sector was more than just an attempt to make the system more efficient for the benefit of domestic manufacturers. Japan worked to put distributors out of the reach of foreign manufacturers through a "systemization" policy that fostered vertical distribution "keiretsu". Japan sought to ensure that the distributors stayed out of reach of foreign manufacturers through its policies regarding the standardization of transaction terms, and measures to limit the availability of alternative distribution channels such as the laboratories and large stores.

6.305 **Japan** argues that MITI has consistently sought to encourage the modernization of the Japanese distribution system over the past three decades for a variety of legitimate policy reasons which were mostly unrelated to capital liberalization or import competition. To the extent that MITI's distribution policies were partially a response to capital liberalization, they were motivated by a desire to modernize and bolster the competitiveness of a relatively backward sector in the economy, not to hinder imports' access to this backward sector. Promoting the competitiveness of domestic industries is a common practice of countries around the world. Japan emphasizes that it sought to promote efficiency and competitiveness of domestic industries, not to block imports. In Japan's view, 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.

6.306 In response to Japan's argument that it intended only to promote efficiency and not protect domestic manufacturers, the **United States** argues that if promoting efficiency were the true goal, then Japan should have welcomed foreign investment in distribution rather than postpone it to the last of the sectors liberalized. According to the United States, the foreign distributors were four to seven times more efficient than domestic distributors. Those efficient foreign distributors could have contributed substantially to the upgrading of Japan's still highly inefficient distribution system. Nonetheless, Japan chose to postpone 100 percent foreign investment in new distribution enterprises until 1976, and in existing distribution enterprises until 1979, and maintained a prior approval requirement for such investment until 1985 and a prior notification requirement until the 1990s. The Seventh Interim Report explicitly acknowledged that foreign interests would accelerate modernization, but concluded that "develop[ing] a system sufficiently capable of resisting the rational systems introduced by foreign capital" should be "emphasized" in MITI policy.[757] The United States also notes that Japanese academic analysis support the US conclusion that the main objective in pursuing the systemization policy was not efficiency but to exclude foreign products though the reinforcement of distribution keiretsu.[758]

6.307 **Japan** responds that multilateral liberalization of trade or investment generally occurs over time, with transitions to avoid excessive shock to the domestic economy. Given that Japan pursued

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[756]Sixth Interim Report, US Ex. 68-8, p. 22.

[757]Seventh Interim Report, US Ex. 69-4.

[758]Sasaki Yasuyuki, Distribution Policies in Japan and the West, 16 June 1995, US Ex. 95-12; Takeshi Shirahige, Current Distribution Issues in Modern Japan, Tokyo, 26 February 1974, p. 108, US Ex. 74-1.

modernization in a way that its distribution sector could compete on a level playing field once full liberalization took place, its distribution modernization policy cannot be considered evidence of protectionist intent.[759] Japan emphasizes that MITI saw the backwardness of the distribution sector as an "Achilles' heel" that would render domestic manufacturers unable to compete with foreign products.[760] Specifically, the concern was that domestic manufacturers would be limited to existing distribution channels while foreign producers, freed from capital restrictions, would be able to choose between using existing Japanese distribution channels or constructing their own modern (and exclusive) distribution channels.

6.308 In the view of the **United States**, the Japanese Government and private sector clearly understood the potential for standardized transaction terms, in combination with scrutiny under the Antimonopoly Law, to restrict foreign firms. For the United States, Japanese Government documents, as well as academic studies of the systemization policy, leave no doubt of Japan's intent to create and support vertically-tied, domestic-manufacturer-dominated distribution channels.[761] This is made clear by repeated statements in the key surveys, studies, and guidance from the time that Japan pursued its transaction terms policies in order to insulate the photographic materials distribution system from foreign competition by promoting vertical keiretsu:

a. According to the United States, in 1967, the Foreign Investment Council issued a report stating that foreign firms "will often become the object of the regulation of the Antimonopoly Law" because their strong capital position would allow them to compete aggressively in Japan. The report called for developing clear "standards" of fair and unfair business practices, to help regulate foreign capital.[762]

b. In 1968, the Distribution Committee's Sixth Interim Report recognized that foreign investment could promote efficiency in several different ways.[763] The report concluded, however, that there were very serious disadvantages to liberalizing investment in the distribution sector, including that "[t]here is a risk that the manufacturing sector will be dominated by controlling the sales routes, bringing about the international subcontracting of Japanese industry".[764]

c. In 1969, a leading Japanese competition policy scholar and member of the Foreign Investment Council published an article along the same lines.[765]

d. In 1969, the Seventh Interim Report stated that under systemization, "more systems will probably be formed in which keiretsu routes are covered under the guidance of the manufacturer"[766] and "… comprehensively and systematically integrate the various aspects of production, processing, and [distribution] services".[767]

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[759]Japan's capital restrictions were imposed through legitimate reservations under the OECD Capital Code, and the liberalization schedule was fully consistent with Japanese obligations under the Code.

[760]Japan notes that existing distribution channels were not perceived as "crown jewels" but as an "achilles heel."

[761]E.g., August 1969 discussion by the JFTC of distribution "keiretsu-ka". This document uses the term "systemization" interchangeably with the word or concept "keiretsunization". US Ex. 69-8, p. 3.

[762]US Ex. 67-5B.

[763]US Ex. 68-8, p. 7.

[764]US Ex. 68-8, p. 8.

[765]"When foreign capital affiliates unfairly give preferences to companies with [which they have] special relationships or to their own primary wholesalers … in terms of price or [transaction] terms, they will thereby become subject to regulation" under the Antimonopoly Law. Iyori Hiroshi, Basic Approach Capital Liberalization and Antimonopoly Law: Basic Approach, Types of Regulation, Sample Cases, Zaikai Keizai Koho, No. 1332-1333, 24 November 1969, p.6-7, US Ex. 69-7.

[766]US Ex. 69-4, p. 7.

[767]US Ex. 68-8, p. 4.

e. MITI's 1970 Guidelines stated that standardized transaction terms will help resist inroads by foreign capital: "… in 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".[768]

f. The 1971 Basic Plan for the Systemization of Distribution made the same point.[769] It makes clear that vertical links are the goal: "[t]he critical point here is to regard the entire process of distribution from production to consumption as a single system".[770] and "there is a need to view individual industry sectors as 'closed systems,' and to achieve a systematic coordination of production, distribution and consumption within such a framework".[771] The Basic Plan emphasized the standardization of transaction terms and the establishment of inter-company electronic information links as important elements for accomplishing systemization. It also stated that MITI's Transaction Terms Standardization Committee had drafted standardized transaction terms for individual sectors such as film, and that MITI "will seek to obtain the cooperation of relevant industry groups to draft standard agreements that incorporate the substance of these guidelines".[772]

g. In 1971, a photo industry journal explained to its readers that "The Ministry of International Trade and Industry's guidelines for normalizing transaction conditions is what may be called an 'immunization' … . 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".[773]

h. The 1975 Manual emphasized that the major issues facing the Japanese film industry include "the liberalization of capital and trade" and "the US landing in Japan". It stated an "urgent need to improve the structure of manufacturers to a capacity that will resist foreign capital affiliated firms" and recommended several actions toward "systemization," including "standardization of transaction terms".[774]

i. A 1976 industry journal article notes that 100 percent capital liberalization was "the most feared development by [Japanese] photosensitive materials makers," and that in preparation for this event, Japanese manufacturers had "requested the government to implement measures centering around legislating antimonopoly measures that could effectively restrict mammoth multi-national corporations from dominating the Japanese industry".

6.309 **Japan** emphasizes that MITI's policies about volume discounts and rebates were not driven by protectionist intent. MITI's objective was increased distribution efficiency. Since large volume transactions lowered distribution costs, the use of volume discounts, if used in a transparent way, may promote the benefits of lower costs. MITI never encouraged progressive rebates, and urged that all rebates be kept to a minimum. For example, Japan contends that the 1967 Cabinet Decision, did not reveal concern to block foreign manufacturers. While the 1969 Survey acknowledges Kodak's role as a competitive factor in this industry, but in no way urges keeping distribution channels "out of the hands of foreign manufacturers". Rather, the 1969 Survey mentions the problems that will arise if new players entering the market introduce irrational transaction terms.

6.310 Japan concludes that another objective of trade term rationalization was to help ensure fair competition in the market. By setting a basic framework to prevent companies from abusing their

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[768]1970 Guidelines on the Standardization of Transaction Terms for the Photo Film Industry, US Ex. 70-4.

[769]"In connection with capital liberalization in the distribution sector, rational transaction terms should be clarified in order to prevent disruption of the [established] order of trade by foreign capital-affiliated firms. US Ex. 71-10, p. 10.

[770]Ibid.

[771]Ibid., p. 6.

[772]Ibid.

[773]US Ex. 71-11.

[774]1975 Manual for the Systemization of Distribution by Industry (Camera - Film), US Ex. 75-5, p. 121-22.

dominant position, but leaving the specific terms to be negotiated case-by-case, MITI sought to secure a level playing field on which foreign and domestic companies would compete fairly by the same rules.

(c) Competitive position of imported products

6.311 In the view of the **United States**, through this variety of reports and specialized expert institutions, MITI directed industry to establish vertical distribution channels controlled by Japanese manufacturers and instructed industry on how to accomplish this goal. The Japanese Government's guidance was critical in binding together *domestic* film and paper manufacturers with wholesalers, and wholesalers with retailers, in large exclusive business structures under each Japanese manufacturer. Japan promoted, enlarged and strengthened these exclusive channels, i.e., carried out the process of systemization, to impede foreign firms from competing in the Japanese market and to protect Japanese manufacturers from foreign competition. The production-distribution structures that it promoted through extensive use of government measures, including administrative guidance and government resources, blocked or substantially impeded access by foreign products to key channels of distribution. The United States claims that by facilitating the sale of domestic products while simultaneously establishing roadblocks to the sale of imported products through the systemization of distribution, Japan severely disrupted the conditions of competition in the Japanese market that otherwise would have prevailed and that would have enabled imports from the United States (and other countries) to take advantage of the tariff concessions granted by Japan in the Kennedy Round.

(i) 1970 Guidelines and transaction terms

6.312 The United States claims that the standardization of transaction terms chilled the ability of foreign manufacturers to offer competitive terms to Japanese wholesalers:

6.313 *First*, the United States argues that the 1970 Guidelines, by setting uniform transaction terms, limited the ability of foreign enterprises to outbid their Japanese competitors. Foreign enterprises could not circumvent the Guidelines because the Japanese government was monitoring the industry's compliance with the Guidelines. MITI declared its expectation that industry would voluntarily comply with the Guidelines and instructed the Photographic Materials Industry Association to make a progress report to MITI within 5 months.[775] In addition, the transaction terms between manufacturers and wholesalers were to be clearly stated in their sales contracts[776] which meant that the JFTC could monitor compliance with the Guidelines when it reviewed contracts involving foreign enterprises pursuant to its "Rules on Filing Notification of International Agreements on Contracts".[777] Once transaction terms are standardized, the JFTC more easily can find that transaction terms departing from the standard are unfair trade practices under the Antimonopoly Law.

6.314 *Second*, the United States submits that the Guidelines established shortened payment terms that enhanced the financial strength of Japanese manufacturers at the expense of wholesalers, and positioned domestic manufacturers to better withstand foreign penetration. Prior to their adoption of standardized transaction terms, competition forced Japanese manufacturers to allow wholesalers and retailers to carry large outstanding balances and to pay over extended periods of time. The new standardized transaction terms shifted the financial burden from the manufacturers to wholesalers and gave domestic manufacturers greater control of the wholesalers.

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[775]Fuji Translation, Rewriting History, Willkie Farr & Gallagher for Fuji Photo Film Co., Ltd., 31 July 1995, US Ex. 70-3.

[776]In presenting the standardized terms to the photographic materials industry, MITI explained that, "to prevent foreign corporations with huge investment capacity from disrupting the trade order, reasonable trade terms must be clearly stated". MITI Guidelines, reprinted in Rewriting History, Tab 11, p. 9, US Ex. 70-3.

[777]JFTC, Rule Regarding International Agreement on International Contract Notification, Rule No. 1, 12 April 1971, US Ex. 71-6.

6.315 *Third*, the United States claims that the Guidelines established standardized terms that were by their very nature more beneficial to Japanese manufacturers than foreign manufacturers. MITI intended Japanese manufacturers to use volume rebates to develop exclusive supply contracts with Japanese wholesalers, whereas foreign manufacturers, with their restricted market share, could not have done this. Volume rebates promote exclusivity by encouraging distributors to purchase from a single source to achieve and maximize the rebate. With volume rebates, distributors only want to enter into exclusive supply relationships with manufacturers that have a sufficient share of the market.[778]

6.316 **Japan** responds that the starting point for analysis should be the wording of the 1970 Guidelines themselves. 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 only made general suggestions related to payment terms, volume discounts, and rebates including that:

(i) interest should be charged for an unusually long payment period (neither the reasonable payment period, the amount of interest to be charged, nor other terms were specified);[779]
(ii) volume discounts should have clear transparent terms (whether and under what circumstances such discounts should be granted and the amount of the discounts were not specified); and
(iii) rebates should be minimized (with no details at all about the specific terms of rebates).

6.317 Japan notes that the Guidelines did not even use the word "standardize" in connection with the suggested transaction terms, and did not encourage standardization or uniformity. They urged the adoption of economically rational transaction terms, and then left it to individual manufacturers, wholesalers and retailers to establish their own specific terms. In fact, the transaction terms of individual manufacturers may and do vary, e.g., Fuji had and continues to have different transaction terms with each of its four independent primary wholesalers. Japan concludes that there is no evidence that the payment terms, volume discounts, and rebates of the various companies in the industry have ever been standardized or uniform.

6.318 Japan states that MITI believed that rationalizing transaction terms would help to ensure fair competition in the market. If opaque, secret, and customer-specific transaction terms were common in the Japanese distribution sector, it would be more difficult to identify unfair trade practices (e.g., dumping, excessively progressive rebates) committed by foreign companies abusing their dominant position. There was no suggestion, however, that foreign enterprises would be held to a different legal standard than domestic enterprises. MITI was merely interested in securing a level playing field in which foreign and domestic enterprises would compete fairly by the same rules.

6.319 Japan submits that there was neither ongoing monitoring nor ongoing enforcement of compliance with the Guidelines. If the Guidelines were the centrepiece for protecting the Japanese photographic film market, the question arises how the relatively passive government efforts served to impose or even encourage their adoption.[780] Thus, the alleged adverse effects should be evaluated in light of both the specific recommendations of the Guidelines and the absence of efforts by the Japanese Government to impose, encourage, or even monitor compliance.

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[778]In 1969, when the Guidelines were issued, domestic producers had 93 percent of the Japanese film market and 87 percent of the paper market - leaving imports with only 7 percent and 13 percent shares, respectively.

[779]The US alleges that "there is no logical difference" between favouring shortened payment terms and advocating charging interest for long payment terms. The Guidelines, however, recommended the interest should be charged only on the promissory notes with "unusually long sight" which is exceptional and "only few in number". It did not favour shorter payment terms.

[780]Japan recalls that only one of three industry associations even bothered to respond to a request for a report of actions taken, and no efforts were directed to specific companies.

6.320 Japan asserts that the United States has not shown that anything in the distribution policies explicitly discriminates against imports. Those policies pursued distribution modernization in a completely neutral manner. In Japan's view, the United States does not identify a single example of a government policy that facially treats imports or other certain products differently.[781] Whereas the United States complains about the underlying effect of the policies to find some adverse impact on imports, Japan contends that

(i) there is nothing inherent about imported products that makes them any more or less able to compete equally in a market characterized by rationalized terms of trade and single-brand distribution;
(ii) there is no factual basis to find any causal connection between the distribution policies and single-brand distribution; and
(iii) there have been either no changes at all, or no changes less favourable for imports, to those policies since the time of relevant tariff concessions.

(ii) 1970 Guidelines and progressive rebates

6.321 With respect to rebates, Japan states that the 1970 Guidelines recommend clearly that they should be kept to a minimum. MITI stated that rebates were often discretionary and without clear criteria, and therefore customers could not be sure whether or not they would receive them. MITI opposed this tendency of rebates to interfere with the business planning of rebate recipients, and sought to discourage this practice.

6.322 In response to Japan's argument that it did not promote the use of rebates between manufacturers, wholesalers and retailers, the **United States** contends that MITI repeatedly endorsed the need for progressive rebates in the photographic materials sector. Whereas the 1970 Guidelines state that rebates "should be kept to a minimum", they do not condemn rebates, particularly because they note the wide use of rebates and conclude that such use "will be allowed".[782] The United States also stresses that at the numerous times, MITI published or republished surveys or other documents clearly emphasizing that MITI favoured progressive rebates.

6.323 **Japan** notes that the US argument seems to be that since MITI did not completely prohibit all rebates, it was somehow encouraging rebates, a rather strange interpretation of the suggestions to "minimize" rebates.

6.324 The **United States** notes that MITI's Business Bureau completed draft guidelines based on the 1969 survey in September 1969 and published them in a photo industry journal.[783] The draft MITI guidelines stated, "[w]ith regard to rebates, progressive rebates should be aggressively promoted in order to facilitate large volume transactions".[784] Subsequently in its cover note to the 1970 guidelines, MITI directed the industry associations to formulate and implement more specific transaction terms,

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[781]For Japan, the only possible exception is the international contract notification requirement. Japan notes that it has raised procedural objections with respect to this measure.

[782]"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". 1970 Guidelines, Japan Ex. B-24.

[783]MITI, Standardization of Transaction Terms: Draft Submitted for Photographic Film, Camera Times, 9 September 1969, p. 2, First Panel Meeting, Supplemental Panel Questions and US Answers, Attachment 2.

[784]Ibid.

and to report back to MITI by November 1970. The photospeciality wholesalers association responded by publishing a "Transaction Outline" which stated, "with regard to quantity-related [volume] rebates, these will be adopted".[785] In 1971, MITI republished the 1969 survey which noted that the "problem" was that "progressive rebates with clear standards that function as volume discounts are not being used very often".[786] The United States further noted that the guidance was being issued based on the recognition that, at the time, rebates were in widespread use in the photosensitive materials sector. In the US view, if MITI had meant for those practices to be eliminated, it would have said so directly.[787]

6.325 The United States argues that Japan promoted the use of rebates as part of a series of government actions to standardize transaction terms and that MITI's efforts in this regard should be examined in terms of the way the Japanese industry understood MITI's recommendation. The United States argues that in addition to guidance that specifically called for progressive rebates, the Japanese film industry interpreted MITI's policy on volume discounts as equating rebates with volume discounts because it saw very little differences between the two. The United States cites the wholesalers' Transaction Outline which explained that rebates were the same as discounts, and notes that the outline stated that "quantity-related [volume] rebates will be adopted".[788] The United States further argues that when the Chamber of Commerce issued its standard contract which it prepared pursuant to a MITI commission, although the Chamber did not include a provision on rebates, it included a specific provision on discounts with the explanation that: "Volume discounts are not uncommon with photographic film. However, since the discounts are paid at set intervals, these discounts seem almost the same as rebates".[789] The United States recalls that the wholesalers' outline and the Chamber's standard contracts were prepared under the close scrutiny of MITI. The United States argues that, accordingly, there can be no question that MITI considered both documents consistent with its policy under the 1970 Guidelines, and that MITI promoted both rebates and volume discounts, to promote incentives for large-volume transactions, which foster "channel exclusivity".

6.326 **Japan** contends that it did not encourage progressive rebates:

> (i) The March 1969 Survey was prepared by an outside research group and only notes the importance of clear criteria for discounts and rebates as part of trade term rationalization.
>
> (ii) In 1969, while a reference to progressive rebates in a draft of the guidelines stressed their ability to function economically like volume discounts, this reference was deleted from the final version of the September 1969 Guidelines.[790]

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[785]Japan Ex. B-31

[786]MITI Business Bureau, Actual Condition of Transaction Terms in the Wholesale Industry, 31 August 1971, p. 62, US Ex. 20 and First Panel Meeting, Supplemental Panel Questions and US Answers, Attachment 4. (The United States notes that this document is an edited and republished version of the 1969 Survey.) The United States argues that Japan failed to quote the entire sentence from the republished version of the 1969 survey, thereby inverting the meaning of the document. The full translation states: "The problem is that categories of rebates that accord significant discretion to sellers such as fixed rebates and goal achievement rebates are the main rebates, and progressive rebates with clear standards that function as volume discounts are not being used very often".

[787]The United States notes that at the same time MITI issued these guidelines for the photographic film sector, it also issued transaction terms guidelines for 12 other sectors. Rebates were widely used in *all* of those 12 other sectors. In 9 out of the 12 sectors, the guidelines use the *exact same* formulation regarding rebates as in the film guidelines, indicating that the formulation clearly was generic. In three of the 12 sectors, MITI called for modifications in the rebate programs, indicating that when MITI wanted changes in rebates, it knew how to say so directly. Japan Ex. B-1.

[788]For a discussion of statements specifically calling for progressive rebates, see para. 6.322 and footnote 782, Japan Ex. B-31.

[789]Japan Chamber of Commerce, Recommendation on Standardized Contracts for Transactions, commissioned by the Ministry of International Trade and Industry, January 1975, p. 22, US Ex. 32.

[790]Japan notes that the "draft" guidelines were never published by MITI.

(iii) The March 1970 JFTC Report made no recommendation about any rebates, and thus said nothing about progressive rebates.

(iv) The June 1970 Final Guidelines regard discounts as a more rational approach for large volume transactions, and then state that "the use of rebates should be kept to a minimum". Thus there is no mention at all of progressive rebates.

(v) The November 1970 Policy Outline by an industry association noted that "quantity-related rebates" could be adopted. Japan emphasizes that the Policy Outline did not represent government thinking, ignored the 1970 Guidelines suggestion to keep rebates to a minimum, and did not even bind association members.

(vi) The August 1971 Survey specifically identified rebates and discounts without clear standards as an irrational practice, and noted that "progressive rebates with clear standards that function as volume discounts are not being used very often".[791] The survey explained a position of an outside research group that (a) rebates should have some rational economic basis; (b) rebates should be based on clear criteria; (c) progressive rebates are more economically rational than fixed rate rebates, since they could function to achieve large volume transactions like volume discounts, but, if used, such rebates should have clear criteria.

(vii) Furthermore, the March 1975 Manual did not even mention progressive rebates.

6.327 Japan points out that of these seven documents, three do not mention progressive rebates at all, and three documents mention progressive rebates, but none of them encourage progressive rebates and none represents a government statement. Finally, the one document that actually encouraged progressive rebates was a draft document reported in an industry journal that, when finalized, deleted any reference to progressive rebates, and instead specifically *discouraged* the use of rebates.

(iii) 1970 Guidelines and single-brand distribution

6.328 Japan emphasizes that MITI policies did not force Japanese wholesalers to become single-brand distributors for domestic manufacturers because the nature of the policies at issue was different: First, the 1970 Guidelines did not encourage rebates; they discouraged rebates and urged that there be some efficiency basis to rebates or volume discounts. Second, the 1970 Guidelines also did not encourage shorter payment terms; they only indicated that after a reasonable period customers should pay interest for continued credit term.[792] Japan emphasizes that these payment terms 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, but are only one element of the cost to the buyer. In the view of Japan, the US assumes, that the manufacturer did not adjust the invoiced price to reflect shortened payment terms, or that the additional costs to the wholesalers were not passed on to their customers.[793]

6.329 The **United States** alleges that Japan promoted shortened payment terms, volume discounts, and progressive rebates, among other transaction terms. Shortening payment terms in effect tightened credit between manufacturers and wholesalers, and between primary wholesalers and secondary wholesalers and retailers. This tightening of credit weakened the wholesalers and made them more

[791]Torihiki Jouken No Jittai, The Institute of Distribution Research's 1969 survey of trade conditions in the film and other industries, Japan Ex. B-1, pp. 6-7, para. 309.

[792]Furthermore, Japan argues that this recommendation was aimed at dealings between wholesalers and retailers, not manufacturers and wholesalers.

[793]In Japan's view, since the United States alleges that the next step in the progression was pushing the shortened payment terms downstream, the United States itself appears to assume that the additional costs of the shorter payment terms were in fact ultimately absorbed not by the primary wholesalers but by their customers.

susceptible to control by Japanese manufacturers in two respects. It increased the wholesalers' need for financial support from the manufacturers and their "keiretsu" banks, and it made it more important for the wholesalers to earn volume discounts and progressive rebates from the domestic manufacturers, which meant focusing their sales efforts on the products of the dominant suppliers, Fuji and Konica.[794] With either a volume discount or rebate, the purchaser has an incentive to concentrate its purchases on the suppliers from which it can expect to receive the greatest rebate or discount from volume purchases, usually the dominant supplier. These types of transaction terms have the potential to enhance manufacturer dominance over distribution.[795] The particular transaction terms promoted by Japan helped cement exclusive vertical relationships in the distribution system, and the standardization of those terms across manufacturers and across wholesalers limited the ability of foreign manufacturers to offer more favourable terms to Japanese manufacturers.

6.330 As to the US argument that the wholesalers were weakened by the shorter payment terms and became more dependent on the manufacturers and, in particular, on volume discounts and rebates, **Japan** responds that the 1970 Guidelines did not encourage the use of volume discounts without reservation, and it never encouraged rebates. In fact, the Guidelines encouraged transparency if volume discounts were given, and discouraged the use of rebates. 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 improved the position of competitors with a customer.

6.331 Japan notes that as to payment terms, the Guidelines' recommendations were also completely unexceptional. The Guidelines did not call for shorter payment terms. They merely stated 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 arrangements. 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.

6.332 In the alternative, even assuming that the 1970 Guidelines facilitated the development of single-brand relationships between domestic film manufacturers and their primary wholesalers by encouraging volume discounts and rebates and tighter payment terms, Japan argues that such encouragement was not inherently unfavourable to imported film or paper. There is nothing intrinsic to the nature of imports that renders them incapable of competing in the context of such distribution practices.[796] Even if the guidelines even went so far as to encourage single-brand distribution,[797] there is nothing intrinsic to the nature of imports that renders them incapable of competing in such a market structure.[798]

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[794]The US submits that volume discounts and rebates favour the dominant supplier. By striving to hit the targets for discounts or rebates from its dominant suppliers, the wholesaler or retailer is likely to receive a much larger value in rebates or discounts than if it hits the targets from its minor suppliers. At the time MITI began promoting standardized transaction terms, Fuji and Konica were (as they are today) the dominant suppliers in Japan. Therefore, volume discounts and rebates favoured them over the foreign manufacturers who had been kept from the market by trade and investment restrictions. By the time Japan began to liberalize those restrictions, the transaction terms and other measures pressed by the Government of Japan had cemented the exclusive relationships between Japanese manufacturers and wholesalers, and to a significant extent the retailers as well.

[795]E.g., MITI's 1970 Guidelines, US Ex. 70-4, p. 6.

[796]Japan explains that the panel in *US - Automobiles* found that a luxury tax on cars priced higher than $30,000 was not inherently less favourable for imports, despite the fact that most imported cars were indeed in the higher priced category. *US - Automobiles*, DS31/R, para. 5.14. By that standard, there is no argument that the provisions of the 1970 Guidelines were inherently less favourable for imports.

[797]According to Japan, the contrary was true, i.e., vertical integration was perceived as a problem to watch, not a policy to promote.

[798]Japan submits that industry experts and even Kodak officials severely criticized Kodak for its failure to invest sooner in its own single-brand distribution network. This criticism reflects a view that single-brand distribution could not be a competitive disadvantage for imports.

(iv) Other distribution measures

6.333 According to Japan, most of the distribution measures identified by the US are merely reports by advisory councils or public corporations, e.g., the various Distribution Committee interim reports, the 1971 Systemization Report, and the 1975 Manual. In Japan's view, none of these reports nor the 1967 Cabinet Decision discussed policies that were inherently disadvantageous to imports.

6.334 Japan argues that the 1967 Cabinet Decision -- which implemented the first stage of capital liberalization -- was quite direct in expressing a concern about the ability of domestic industry to compete with foreign rivals. The Japanese Government sought to promote the efficiency and competitiveness of domestic industries, not block imports. In Japan's view, the conclusions drawn by the United States have no support in the text of the Cabinet Decision. Japan stresses that there is no discussion of promoting domestic manufactureres from foreign competition at all, let alone a discussion of using distribution policies to protect manufacturing companies.

6.335 Japan argues that the international contract notification requirement does not allow the JFTC to take action against foreign manufacturers that are offering more competitive terms than their domestic counterparts. This provision is merely a reporting requirement applicable to trade transactions in general, import as well as export transactions, for the purpose of policing Antimonopoly Law violations. Japan emphasizes that the JFTC does not enforce MITI Guidelines and questions the relevance of the international contract notification requirement to film given that, during the 1970s, sales of Kodak film in Japan were made exclusively by a domestic Japanese company, Nagase, which was not subject to that requirement in respect of contracts with other wholesalers, secondary dealers, or retailers.[799]

6.336 Japan concludes that the competitive conditions allegedly established by MITI's distribution policies - assuming they constitute "measures" for purposes of non-violation complaints - are not less favourable for imported film and paper than for domestic products. Japan emphasizes that competitive conditions must be examined exclusively on the basis of the provisions of the alleged measures themselves, and not to any incidental consequences, such as single-brand distribution. Japan maintains that there is no causal connection between the alleged measures and single-brand distribution or between single-brand distribution and the alleged impeded market access. Moreover, none of these distribution measures draws any formal distinctions between imported and domestic products. For these alleged measures to establish less favourable competitive conditions for imports, their provisions must somehow be inherently disadvantageous to imports. However, according to Japan, distribution modernization policies themselves were not inherently disadvantageous to imports.

(v) Black and white film and paper

6.337 Moreover, Japan points out that the US allegations are completely irrelevant to black and white film and paper. For Japan, the US "distribution bottleneck" theory is premised on the large number of retail film outlets, but those are *colour* film outlets. However, black and white film is a niche product that is sold through a much smaller number of retail outlets, generally photospecialty retailers. Thus Japan concludes that the US theory is not even applicable to black and white film.

6.338 With regard to *paper*, Japan asserts that the US claims focus on Japan's alleged encouragement of the domestic film and paper manufacturers' vertical integration into *colour* photofinishing, thereby allegedly creating a "captive market" for colour paper. However, what matters in the present context

[799]Kodak had made a fundamental decision to rely exclusively on Nagase, and did not reevaluate this marketing strategy until years later, long after the period in question. Although Kodak reestablished a subsidiary in 1977, that subsidiary only provided support to the distributors. It was not until 1983 that Kodak reassessed that business strategy and decided to become more active. Japan Ex. B-45.

is that it has nothing to do with black and white paper. With respect to the 1967 tariff concessions, which were made only on black and white film and paper, these facts provide an additional reason why there is no upsetting of competitive conditions on account of "distribution countermeasures".

6.339 On Japan's argument related to the competitive dynamics of a market for black and white film, the **United States** responds that the subject and title of this dispute is consumer photographic film and paper. That is because 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.[800] Accordingly, Japan's focus on the relationship between the Kennedy Round concessions (on black and white products) and current colour film and photo-finishing outlets is not relevant. Given that black and white film (and paper) was the dominant product at the time the Japanese Government 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.

(d) Causal connection between distribution measures and competitive position of imports

6.340 **Japan** emphasizes that even if the Panel looks beyond the provisions of the alleged measures and attempts to evaluate their practical consequences, the US claims fail because of the lack of any actual causal connection (i) between the alleged measures and current single-brand distribution, or (ii) between current single-brand distribution and the alleged current impeded market access.

6.341 According to Japan, even if the 1970 Guidelines are a "measure" for purposes of Article XXIII:1(b), they are not a "measure" that has anything at all to do with the alleged nullification or impairment of the benefits of tariff concessions. In Japan's view, the US claims that the alleged nullification or impairment comes from single-brand distribution, while being unable to show any nexus between the 1970 Guidelines and single-brand distribution. Private companies had adopted single-brand distribution prior to the alleged measures. Japan alleges that the United States tries to shift the focus from the measures themselves to the market structure that allegedly disadvantages imported products. However, GATT precedent has consistently focused on the measures themselves, and not market outcomes. Japan adds that even if the panel were inclined to depart from this past GATT practice, there is no factual basis to conclude either that MITI policies created the market structure, or that the market structure in fact disadvantages imported consumer photographic products.

6.342 For Japan, it is also important to examine whether there is current nullification or impairment. Putting aside the relationship between MITI's policies and the private sector during the 1960s and '70s, what matters is whether there is any causal connection between the alleged measures and *current* business decisions by wholesalers and outlets regarding what kind of film and paper to purchase. In Japan's view, since the alleged "measures" are no longer in effect, there is no such connection.

6.343 Even if the US interpretation of MITI's distribution policies argument were accurate, in Japan's view, there is no upsetting of the competitive position for imported products. According to Japan, the United States alleged that MITI has sought over the past 30 years to establish and then maintain an exclusionary market structure for film and paper in which foreign brands are blocked from the primary distribution channels. For Japan, in light of the nature of the suggestions being made, and the private sector response to those suggestions, it is not credible to argue that there is some connection. While the United States has submitted voluminous background information on the evolution of government policy thinking, however, the ongoing policy debate during the process of policymaking is much less

[800]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 accounting for only 3 percent.

relevant than what eventually happened. Japan emphasizes that private sector actions happened either too early or too late to have any meaningful connection to the government and advisory committee suggestions being made in the early 1970s.

6.344 For the **United States**, there is ample evidence to suggest that the nearly simultaneous decisions of Fuji and Konica to tighten payments and introduce new rebates and discounts in 1966 were in response to Japanese Government policy. By 1965-66 the Japanese Government already had begun the process of working closely with industry to study and devise ways to respond to capital and trade liberalization. The Industrial Structure Council's Distribution Committee had studied the need for rationalized transaction terms in its Fifth Interim Report in 1965. Also in 1965, MITI worked with the Japanese photographic film and paper manufacturers in the Natural Colour Photography Promotion Council (NCPPC) to devise means to prepare for trade and capital liberalization. Among other things, the NCPPC considered and reported on specific "import suppression counter measures".[801] The United States concludes that the Japanese Government's guidelines and administrative guidance to industry had a clear purpose at the time they were given, and they accomplished their objectives very effectively.

6.345 **Japan** responds that the United States elevates preliminary deliberations of the Industrial Structure Council's Distribution Committee and the Natural Colour Photography Promotion Council (NCPPC) and the Industrial Structure Council's Fifth Interim Report to the level of Japanese Government policy. In Japan's view, these were activities of non-governmental bodies: (i) that were in the early stages of studying distribution issues, and were not yet even making specific recommendations; (ii) that took place two years prior to the 1967 Cabinet Decision endorsing the broad concept of modernizing the distribution sector; and (iii) that took place *five years* prior to the first specific government statement on the issue of rationalizing transaction terms for the photographic products industry. Therefore, in Japan's view, the United States has not submitted evidence to link the actions taken by Fujifilm and Konica regarding transaction terms to governmental action.

(i) Introduction of transaction terms

6.346 As to the timing problems with this alleged link between the introduction of distribution measures and the upsetting of competitive conditions for photographic materials, Japan argues that private companies had taken actions themselves regarding payment terms and rebates well before any actions by the Japanese Government regarding "standardized"[802] transaction terms. For Japan, it is clear that these documents cannot have caused Fuji's and other manufacturers' decision to implement e.g., volume rebates. For example, Konica began tightening payment terms in 1962 and Fuji started in 1966. Trade journals discussed these business developments and the quite natural desire of the domestic manufacturers to improve their accounts receivables through shorter payment terms. Thus, the manufacturers' tightening of transaction terms for their primary wholesalers as well as Fuji's volume discount policy predate both the 1967 Cabinet Decision and the 1970 Guidelines. Fuji made no change in its policy in response to the 1967 Cabinet Decision. Regardless of MITI's 1970 Guidelines, Japanese manufacturers in this sector had already begun to adjust their rebate policies and shorten payment terms before 1967, three years or more before MITI first announced its suggestions.

6.347 The **United States** notes that Japan does not deny that its manufacturers implemented shortened payment terms, rebates, and volume discounts. While Japan raises a question of timing, the United States contends that there is no timing mismatch in its position. Specifically, the United States argues

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[801]Studying a Policy for Coping: Natural Colour Photograph Promotion Council, Approaching Liberalization of Trade in Colour Film, Camera Times, 2 March 1965, US Ex. 65-3.

[802]Japan notes that it distinguishes "standardization," with its implication of uniformity, from "rationalization," which does not have this nuance. Japan points out that the United States consistently translates "tekisei(-ka)" as "standardization" rather than the more accurate alternative "rationalization". In Japan's view, if the Japanese original had meant "standardization", it would have used the term "ityoujun-ka".

that there were two purposes for Japan's transaction terms policies, i.e.: (1) standardizing transaction terms in order to create a benchmark against which to judge the "fairness" of competition from foreign firms using non-standard terms, and (2) implementing specific terms that promoted channel exclusivity.

6.348 According to the United States, in terms of the *first* goal, the timing of Japan's measures was perfect. The Japanese Government actively pressed for standardized transaction terms in the 1968-75 time frame precisely when lowering tariffs and moving toward the first significant liberalization of capital investment. Japan wanted its manufacturers, primary wholesalers, and secondary wholesalers to standardize transaction terms in order to resist this increasing competition by means of scrutiny under the Antimonopoly Law. The United States emphasizes that the 1969 survey of transaction terms submitted by Japan[803] shows that, at this time, transaction terms were not standardized between manufacturers, primary wholesalers, secondary wholesalers and retailers. 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. It was also at this time that Japan implemented Notification 17 to prevent foreign manufacturers from offering attractive premiums to wholesalers, and Rule No. 1 under the international contract notification provisions of the Antimonopoly Law, which ensured the opportunity to scrutinize each contract between foreign manufacturers and Japanese wholesalers for "unfair" departures from standardized terms.

6.349 The United States emphasizes that 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. These documents also indicated that long payment terms were common at these levels of the distribution system. In the US view, Japan wanted to advance its keiretsu distribution system beyond the first tier of manufacturer-to-primary-wholesaler to encompass these lower levels as well. Moreover, greater efforts were necessary to accomplish keiretsu-nization at these levels, since it was not necessarily in the interest of the wholesalers or retailers. The low levels of foreign access to the secondary wholesalers demonstrates that Japan's policies were largely successful at this level as well.

(ii) Introduction of single-brand distribution

6.350 For **Japan** it is clear that neither volume discounts nor rebates were responsible for the decision by primary wholesalers to become single-brand in the Japanese market. Private companies had adopted single-brand distribution prior to any government action. Single-brand distribution had emerged by the mid 1960s, and was essentially complete by 1968.[804] Konica's primary wholesalers were single-brand since at least 1955. Three of Fuji's four major primary wholesalers were already single-brand wholesalers well before 1970. Accordingly, single-brand distribution of film was already the industry norm by 1968, years prior to the 1970 Guidelines, which were the only government statement concerning transaction terms,[805] and other alleged measures. Thus, well before the 1970 Guidelines, the industry had already shifted to single-brand distribution and not surprisingly, the 1970 Guidelines said nothing about single-brand distribution. Japan concludes that the history of business decisions in this industry reveal the timing problems of the US theory of causation because it is impossible for a government action to cause something that happened before that government action was taken.

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[803]Japan Ex B-1.

[804]The only remaining multibrand wholesaler was Asanuma, which became single-brand in 1975 after being rebuffed by Kodak when Asanuma tried to reestablish direct dealing with Kodak.

[805]The other reports and surveys were not formal government actions or statements. Moreover, even these items came after single-brand distribution had emerged as the predominant industry practice.

6.351 Japan points out that Kodak's agent Nagase had acquired Kuwada, and turned the formerly multibrand primary wholesaler into a single-brand wholesaler, and became a direct competitor of the other independent primary wholesalers in 1967. Thereafter, independent primary wholesalers would have to compete in selling Kodak with their supplier (an obvious impossibility given that the supplier could always ensure its ability to underprice the independent wholesaler) or to act as a secondary wholesaler. Those that had the ability to remain a primary wholesaler for another manufacturer chose this course of action. This decision was not because of rebates or volume discounts, it was because Kodak had chosen exclusive distribution at the primary wholesale level and in so doing effectively excluded independent primary wholesalers from a role in distributing Kodak products. In Japan's view, ultimately, the success or failure of volume discounts and rebates in attracting business from a wholesaler is a matter of business judgement. However, neither necessarily leads to exclusivity. Wholesalers must choose between the advantages of lower purchase costs from volume discounts and a greater variety of brands which is a pure business decision.

6.352 Japan states that Asanuma remained a wholesaler of Kodak film until 1975. Thus Asanuma did not terminate its relationship because of payment terms, volume discounts, rebates, "keiretsu" relationships or purported policies of the Japanese Government to encourage single-brand distribution. In Japan's view, Asanuma terminated its relationship with Kodak because Kodak was unwilling to deal with it directly as a primary wholesaler. Similarly, the other primary wholesalers remain single-brand Fuji distributors because they have made a business decision to do so.[806]

6.353 The **United States** contests Japan's argument that its measures could not have caused the alleged effects because Japanese manufacturers began implementing shortened payment terms and volume discounts and rebates in 1966, before the series of Japanese Government measures from 1968 through 1975 that called for such transaction terms. In the US view, there are no timing problems in the US argument.

6.354 The United States notes that there were two purposes for the Government of Japan's transaction terms policies: (1) standardizing transaction terms in order to create a benchmark against which to judge the "fairness" of competition from foreign firms using non-standard terms; and (2) implementing specific terms that promoted channel exclusivity. In terms of the first goal, Japan actively pressed for standardized transaction terms in the 1968-75 time frame precisely as Japan was lowering its tariffs and moving toward the first significant liberalization of capital investment. Japan wanted its manufacturers, primary wholesalers, and secondary wholesalers to standardize transaction terms in order to resist this increasing competition by means of scrutiny under the Antimonopoly Law. The 1969 survey of transaction terms[807] shows that at this time, transaction terms were not standardized between manufacturers and wholesalers or between primary wholesalers and secondary wholesalers retailers. 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. It was also at this time that Japan implemented Notification 17 to prevent foreign manufacturers from offering attractive premiums to wholesalers, and Rule No. 1 under the international contract notification provisions of the Antimonopoly Law, which ensured the opportunity to scrutinize each contract between foreign manufacturers and Japanese wholesalers for "unfair" departures from standardized terms.

6.355 The United States also emphasizes that 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

[806]Affidavit of Takenosuke Katsuoka, Japan Ex. A-11; Affidavit of Kaoru Konno, Japan Ex. A-15, Affidavit of Yukiyoshi Noro, Japan Ex. A-14, Affidavit of Tomihiko Asada, Japan Ex. A-12.

[807]Japan Ex. B-1

and secondary wholesalers and retailers. These documents also indicated that long payment terms were common at these levels of the distribution system. Japan wanted to advance its keiretsu distribution system beyond the first tier of manufacturer-to-primary-wholesaler to encompass these lower levels as well. Moreover, as the United States provided evidence for, greater efforts were necessary to accomplish keiretsu-nization at these levels, since it was not necessarily in the interest of the wholesalers or retailers. The low levels of foreign access to the secondary wholesalers demonstrates that Japan's policies were largely successful at this level as well.

(iii) Governmental endorsement of private actions

6.356 The United States argues that, to the extent that manufacturers already had implemented some of the desired transaction terms, the Japanese Government's endorsement of those terms made clear that they were approved government policy, and should be perpetuated or strengthened.

6.357 **Japan** contends that the companies' economic self-interest was a sufficient reason to maintain rationalized transaction terms. Moreover, Japan points out that the alleged objective behind the adoption of these transaction terms, i.e., single-brand distribution, is the common form of distribution in the film industry in every market in the world. It results from business decisions as to how to most effectively compete. Manufacturers selling in Japan would not need the government's endorsement to adopt and maintain practices and market structures that had proven successful in all other markets in the world. Therefore, payment terms, discounts, and rebates were not responsible for the evolution to single-brand distribution in Japan any more than they were in the United States or the European Union. Nor are the use of payment terms, discounts, and rebates as a tool of competition constrained in Japan. They have been and remain competitive tools constrained only by the application of the relevant competition statutes equally applied to both foreign and domestic competitors.

(iv) Downstream standardization

6.358 According to the **United States**, Japan wanted these transaction terms implemented and standardized further downstream in the distribution system. The surveys and the guidelines from the late 1960s and early 1970s note that transaction terms between primary wholesalers and secondary wholesalers and retailers were not yet, but should be, standardized.[808] Pushing its systemization policies further downstream would help ensure the stability of the system as a whole, and its resistance to foreign capital enterprises. When wholesalers actually began to implement the terms suggested by MITI, the retailers raised objections.

6.359 **Japan** responds that this argument ignores the economic incentives for the transaction terms to pass downstream and the actual economic consequences of downstream transaction term rationalization. As to the US theory that tightening terms at the manufacturer-wholesaler level created financial pressure on the wholesaler, Japan responds that efforts to shorten transaction terms at the wholesaler-retailer level would actually *help* wholesalers by relieving the financial pressure from shorter payment terms at the manufacturer-wholesaler level. Thus, there could be no actual financial effects on the wholesaler, which would then not lead to the exclusive manufacturer-wholesaler relationship alleged by the United States.[809] If manufacturers and wholesalers had, of their own accord, adopted shorter payment terms, rebates, and volume discounts, inevitably these changes would eventually have their own effect on the downstream terms from the wholesaler to the customer, regardless of what the government recommends as distribution modernization. Japan concludes that the alleged government's endorsement of the wholesaler-to-retailer transaction terms, which were the likely consequence of the changes already

[808]1970 Guidelines, US Ex. 70-4.

[809]According to Japan, the United States cites trends in wholesaler profitability. Yet this data in fact shows that as the manufacturers tightened payment terms in the mid 1960s, profitability actually increased. The decline in profitability did not happen until several years later. The timing of these trends hardly supports the US allegations.

taking place in the manufacturer-to-wholesaler terms, had nothing to do with the underlying economic forces pushing transaction terms downstream.

(v) Uniformity and standardization

6.360 In the view of the **United States**, the standardization of transaction terms served two purposes: (i) to encourage vertical alignment of distribution, and (ii) to establish a baseline for standard industry practices, the departure from which would be scrutinized under the Antimonopoly law. The fact that the domestic manufacturers had implemented rebates, discounts, and shortened payment terms in 1966 or 1967 does not mean that the terms were uniform across manufacturers and wholesalers. The Japanese Government needed industry to standardize the terms, and to keep them standard, in order to resist inroads from foreign capital.

6.361 With regard to the US emphasis on the importance of the government in ensuring *uniformity* of transaction terms, **Japan** argues that this argument has no support in the government actions or the private sector actions during this period, given that rationalized transaction terms did not limit the ability of foreign or domestic manufacturers to offer more competitive terms.

(i) In particular, Japan emphasizes that the 1970 Guidelines did not specify the payment terms, the interest rates on extended payment terms, the terms of volume discounts, or the terms of rebates. None of the other documents identified by the United States specifies target "standards" for any of these elements.[810] The Guidelines provided only broad suggestions, not specific details of suggested transaction terms. Moreover, the Guidelines did not even use the word "standardize" in connection with its suggestions regarding transaction terms.[811]

(ii) As to the US argument that the "standard contract" drafted by an industry group[812] pushed for uniformity, Japan responds that the draft "standard contract"[813] clearly left to individual negotiation every major element of the business transaction and would not prevent a competitor from offering better terms to win business. Thus standardizing of any specific transaction terms was not intended.

(iii) In Japan's view, the idea that rationalizing transaction terms somehow limited the ability of foreign manufacturers to offer competitive terms also contradicts recent US statements. The 1990 Guidelines state that "Business operators trying to enter a new business sector are clueless as to the amount of rebates it would offer in order to maintain a position superior to its rivals".[814] Here the 1990 Guidelines, which are supported by the United States, assume that the rationalization of transaction terms will help new entrants, including foreign manufacturers, to offer competitive terms.

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[810]Japan notes that to the extent the 1969 Survey contained examples of actual transaction terms, such information is quite common in such factual surveys. There is no indication the survey evaluated any specific terms either favourably or unfavourably, and thus they could not be "targets".

[811]Japan states that the United States consistently translates "tekisei(-ka)" as "standardization" rather than the more accurate "rationalization". If the Japanese original had meant "standardization," it would have used the term "hyoujun-ka". e.g., see US Ex. 71-11 (Zenren Tsuho, August 1971); US Ex. 70-4 (Zenren Tsuho, July 1970); US Ex. 69-5 (Zenren Tsuho, November 1969).

[812]The contract was reprinted in an industry trade journal at the time. Nihon Shashin Kogyo Tsushin (1 July 1972). Japan Ex. F-2. This "standard contract" was made as a model form of contract and did not have any binding effect whatsoever. MITI merely encouraged the Japan Chamber of Commerce and Industry to draft it. Its purpose was to encourage the private sector to use written forms and make contracts more transparent.

[813]Japan underscores that the Standard Contract: (i) left blank the number of days in the payment period; (ii) left blank the interest rate to be charged on late payment; (iii) left blank the discount rate for cash discounts; (iv) indicates that volume discounts should be in accordance with "separately specified standards," and (v) makes no mention of rebates at all.

[814]Shoukankou Kaizen No Kihonteki Houkou Ni Tsuite (Basic Distribution to be Taken for the Improvement of Commercial Practices), 20 June 1990 [hereinafter "1990 Guidelines"], US Ex. 90-5, p. 2.

6.362 Japan concludes that even assuming the US allegations about the timing, the meaning of the 1970 Guidelines, and their effect on encouraging exclusivity, were correct, these US arguments still would fail because they assume that there were legal constraints on the ability to offer competing transaction terms to customers. However, there were no constraints on a competitor, whether foreign or domestic, to offer more attractive transaction terms.

(e) Financing for rationalization, systemization and standardization

(i) JDB funding for joint distribution facilities

6.363 The **United States** claims that Japan also promoted the vertical integration of manufacturers and wholesalers through administrative guidance and financial incentives for manufacturers, wholesalers and retailers to establish joint distribution facilities. The establishment of common facilities between these different levels of the distribution system bound the participating companies closer together and made it more difficult for foreign suppliers to establish or maintain relationships with the participating distributors. The Distribution Committee's Seventh Interim Report recommended financing by the Japan Development Bank ("JDB") to promote systemization.[815] In 1976, the JDB provided a subsidized loan of 550 million yen to Konica to establish a joint distribution centre for Konica and its four primary wholesalers.[816] JDB funding of the distribution centre gave Konica the means to establish strong, physical and electronic ties with its primary wholesalers and consequently stripped the wholesalers of their independence and made it all but impossible for other manufacturers to overcome the wholesalers' exclusive relationships with Konica.[817] The US alleges that the JDB's selective financing of Japanese manufacturers in their attempts to systematize distribution channels for photographic film and paper upset the conditions of competition between imported and domestic products since the loans helped to further tie domestic manufacturers to primary wholesalers that otherwise would have been available to distribute imported products.

6.364 **Japan** contends that Konica had already acquired its primary wholesalers before the JDB loan and that the loan was thus too late to encourage vertical integration. No government intervention is necessary to tell subsidiaries to cooperate with the parent company. For Japan, the cooperation between Konica and its primary wholesalers and their joint development of a distribution facility cannot be the result of some government plan to strengthen the relationship between these primary wholesalers and Konica.

6.365 The **United States** responds that Japan does not deny that the loan was made for the purpose of establishing the joint distribution between Konica and its wholesalers, or that the centre was in fact established using the loan. As to Japan's argument that Konica already had acquired its primary wholesalers at the time, the United States contends that Konica merged with its last two independent primary wholesalers (i.e., Haruna Shokai and Daiwa Shokai) on 13 July 1977, more than a year after the JDB loan.[818] The United States maintains that the establishment of the joint distribution centre further interwove the manufacturer and its wholesalers, making it more difficult for a foreign supplier to establish a relationship with, or purchase, a Konica wholesaler.

6.366 According to **Japan**, given that single-brand distribution is not inherently unfavourable to imports, it follows that MITI's encouragement of systemization, the JDB loan to Konica for a joint distribution

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[815]US Ex. 69-4.

[816]The Direction of Regulating Multi Level Marketing, Catalog Sales and Door to Door Sales (Eleventh Interim Report, Dec. 1974, US Ex. 74-6.

[817]The President of Konica at the time referred to the distribution centre as "a kind of business merger on the distribution front". Standing Before a Trial Photographic Distribution Industry, Camera Times, 8 May 1976, US Ex. 76-4.

[818]An industry journal article from 20 July 1977 reported the merger: Era for Reorganizing Distribution: "Retailers Are Like Octopi," Shashin Kogyo Junpo, 20 July 1977, p. 8, US Ex-37.

centre - which at most, even according to US allegations, merely lent some encouragement to single-brand distribution - were not inherently unfavourable. Japan explains that the JDB did not and does not evaluate applications from foreign enterprises that carry foreign products any differently than it evaluates applications from domestic enterprises.[819] Thus, if Nagase (i.e., Kodak's importer) and Kuwada (i.e., Nagase's single-brand primary wholesaler subsidiary) applied for a loan to build a joint distribution centre, the JDB would have evaluated the application based on the same criteria used to evaluate Konica's application.

6.367 As to Japan's argument that the JDB in the 1970s would have, and today would, provide the same type of loan to foreign manufacturers, the **United States** rebuts that the fact remains that the only manufacturer who received such a loan was Japanese.[820]

(ii) SMEA loans to photoprocessing laboratories

6.368 According to the United States, as colour photography became popular in the 1960s and 1970s, photoprocessing laboratories became a potential alternative distribution channel, and a potential threat to the oligopolistic distribution system maintained by Fuji and Konica. In 1968, the director of the Small and Medium Enterprise Agency (SMEA) called for applying SMEA programs to improve the structure of medium and small businesses in light of the "advancing capital liberalization," and as "protective countermeasures against the selling of oneself to foreign capital".[821] The 1969 MITI-commissioned survey of transaction terms in the photographic sector[822] 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". 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". Among the recommended measures were, "subsidize the processing industry".[823] In response, the United States claims, MITI's SMEA gave substantial subsidies to the photoprocessing industry aimed at modernizing the equipment in the facilities in anticipation of capital liberalization. In July 1967, SMEA approved "colour film development and printing laboratories" as one of four sectors deemed eligible that year for subsidized loans.[824] The Chairman of the Laboratories Association, who also was the president of Fuji Colour Service,[825] 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".[826] When the laboratories were designated as eligible for another SMEA subsidy program in 1973, the chairman of the Laboratory Association again stressed the need to respond to trade liberalization.[827] Japanese film manufacturers used SMEA financing to convert black and white to

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[819]Japan notes that since 1984, the JDB has been promoting imports by providing loans for the construction of distribution facilities and service facilities for imported products. JDB Annual Report 1995, p. 26-27, Japan Ex B-36.

[820]According to the United States, Japan also argues that it was in Konica's interest to establish the joint distribution centre, as if that fact alters the Government's responsibility for intervening in the market to facilitate that result.

[821]Small and Medium Enterprises Director, Otsutake 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, 10-15, US Ex-12.

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

[823]Ibid.

[824]The 1967 and 1968 SMEA Annual Reports confirm that the SMEA 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.

[825]The United States notes that all chairmen of the All Japan Laboratories Association (Laboratories Association) have been Fuji employees.

[826]Murakami Eiji, With This Opportunity as Designated Industry, Let's Strive for Further Development of the Lab Industry, CFA News, Special Issue, 1967, p. 4, US Ex-9.

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

colour photo processing laboratories in the late 1960s and early 1970s. During this time, SMEA provided approximately 160 million yen to support this effort. After conversion, these laboratories tended to remain closely affiliated with the Japanese manufacturers. These subsidies helped tie the laboratories into exclusive relationships with the domestic Japanese photographic film and paper manufacturers.

6.369 The United States submits that the close links between domestic manufacturers formed under this SMEA program helped domestic manufacturers close off another distribution channel for film, since photoprocessing laboratories are the primary market for photographic paper and an important distribution channel for photographic film. Because the laboratories make frequent stops at retail stores to pick up exposed film for processing and printing and drop off finished prints, the laboratories are in a good position to deliver new undeveloped film as well. Moreover, the brand of developing and processing equipment the laboratory uses often corresponds to the brand of photographic paper it uses and the brand of film distributes. Consumer perception, if not technology, often suggests that the best prints come from using the same brand of film, paper, and processing equipment. Accordingly, 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. A laboratory that uses Fuji equipment often will use Fuji paper and chemicals, and if it distributes film, it likely will be Fuji.

6.370 **Japan** responds that there is no logical nexus between government financing and the trend toward vertical integration. The trend toward affiliation 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 1960s which shows that the timing of SMEA financing had nothing to do with this trend.

6.371 In the view of the **United States**, given that 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. Therefore, in the US view, Japan severely disrupted the conditions of competition in the Japanese market that otherwise would have prevailed and that would have enabled imports from the United States (and other countries) to take advantage of the tariff concessions granted by Japan in the Kennedy Round.

6.372 Given that, in **Japan's** view, single-brand distribution is not inherently unfavourable to imports, it follows that MITI's encouragement of systemization and SMEA financing for modernization of photofinishing laboratories - which at most, even according to US allegations, merely lent some encouragement to single-brand distribution - were not inherently unfavourable. Japan emphasizes that the SMEA financing to photo laboratories was available to any laboratory with any affiliation to any manufacturer. The financing was designed to help the small laboratories, not the major manufacturers, to buy or lease new equipment to handle the new developing technologies for colour film. Obviously smaller laboratories would experience more difficulty financing such a large capital expenditure. Laboratories receiving the financing were free to choose the type and brand of all the equipment they acquired with the help of the loans. Once the laboratories obtained the new equipment, they were then available as customers to anyone who could supply the colour paper they would need to use the new technology. Japan argues that this independent source of financing actually reduced any dependence the laboratories would have on the manufacturers. In Japan's view, the United States has not explained why the SMEA financing would favour Japanese manufacturers rather than any other supplier with a competitive product.

6.373 In response to Japan's argument that the SMEA programs did not specify that the laboratories receiving the subsidies purchase only equipment by Japanese manufacturers, the **United States** maintains that the manner in which SMEA operated these programs disadvantaged foreign manufacturers. In the US view, MITI in general has operated its SMEA programs to support its industrial policy goals, including preparing Japanese industry to confront trade and investment liberalization.[828] 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". To obtain certification as a management consultant, an individual must pass an examination on MITI and SMEA industrial policies, including distribution policy.[829] In the US view, these policies have contributed to Fuji's strong and extensive ties with Japanese photoprocessing laboratories, and that these ties have reinforced Fuji's dominant position in the market.[830]

6.374 **Japan** underscores that SMEA loans continue to be made available to laboratories affiliated with both foreign and domestic manufacturers. From the fiscal year 1993 to fiscal year 1995, 48.2 percent of the loans were distributed to Fuji laboratories, 9 percent to Kodak laboratories and 7.1 percent to Konica laboratories.

6.375 The **United States** contends that the receipt of a handful of subsidized loans under the SMEA programs by Kodak-affiliated laboratories in the period from 1993 through 1995 does not disprove that the program has operated for years to strengthen Japanese industry's control over its laboratory network.

(f) Electronic information links

6.376 The United States submits that MITI saw the development of information links as an integral part of its distribution systemization efforts and strongly advocated improving computer linkages to cement the closed vertical distribution system and ensure its perpetuation, e.g., in the 1969 Seventh Interim Report or the 1975 Manual. MITI created, beginning in the mid-1970s, a series of government-industry entities to facilitate the creation of computer networks between Japanese manufacturers and Japanese distributor. 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.

6.377 **Japan** responds that there is no basis for assuming that MITI's systemization policies, e.g., the creation of information ties, had any exclusionary impact. MITI's policies recognized and addressed all distribution channels for film, including distribution channels used by imports.[831] For Japan, there

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[828]"The need to increase international competitive strength with the liberalization of trade at the start of the 1960s made it even more necessary to do this [i.e., improve the facilities of SMEs]. The SME modernization policies that got fully underway in the 1960s were a policy response to this necessity". Takashi Yokokura, Chapter 20: Small and Medium Enterprises, Industry Policy of Japan Edited by Ryutaro Komiya, Masahiro Okuni, and Kotaro Suzumura, 1988, p. 521. Chapter 11: The Development of New Policy Measures, MITI History, Vol. 15, 31 May 1991, p. 431-2, US Ex. 70. Among the specified industrial policy objectives were response to "capital and trade liberalization". Ibid.

[829]As explained in a recent guide to becoming a MITI-certified "management consultant": "Individuals taking the examination should review the latest and immediately previous editions of the [SMEA] White Paper. This is an extremely useful source for understanding … the direction in which the government it attempting to guide small and medium enterprises". Nagano Hiroji, An Easy Guide to Becoming a Consultant for Small Business, 26 January 1997, p. 35-36, US Ex. 104.

[830]"The source of power for building Fuji Film's high market share, which pays no heed to [Agfa retailer Nihon] Jumbo's aggressive pricing policies, is the keiretsu-nization of wholesalers and laboratories. This structure is the foundation for a strong corporate system that produces big profits from film and printing paper". "Firm Control of Film Distribution - The Fair Trade Commission does not take action as discounters pose no threat," Special Feature - Part 2, Nikkei Business, 28 March 1993, pp. 16-19, US Ex-79.

[831]Japan notes that 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 Distribution Manual was prepared. Thus imports were not left out of the process.

is thus no reason why imports would have encountered difficulties because they did not share the same standardized forms and practices.

6.378 The **United States** contends that Japan was well aware that creating information links between manufacturers and their distributors risks reinforcing oligopolistic distribution structures and limiting competition.[832] The JFTC's list of highly oligopolistic industries includes the Japanese photographic film and paper industry. In these circumstances, the United States argues that the formation of Fuji-controlled information links should have raised concerns by the Japanese Government rather than its explicit support.

6.379 As to the US argument that Japanese manufacturers established on-line computer links with their primary wholesalers as a result of the guidance by the 1975 Manual, **Japan** responds that Fuji did not establish its first on-line connection with a primary wholesaler until 1989. 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.

6.380 According to the **United States**, the Japanese Government's support and promotion of information links spanned nearly 25 years:

a. In 1968, the importance of information flows was first identified in the Sixth Interim Report which stated that "appropriate conditions of location, the formation of distribution information networks should be promoted …".[833]

b. In 1969, in the Seventh Interim Report, MITI's Distribution Committee set forth a specific information "systemization" program which was premised on the belief that information flows were "a fundamental key to pursuing systemization of distribution activities".[834]

c. In 1971, the Distribution Committee's Ninth Interim Report[835] reiterated the importance of strengthening information ties as part of distribution systemization and called for the establishment of "guideposts" for development of information ties needed to strengthen horizontal and vertical linkages of 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 centres and the wholesale business districts".[836]

d. With the 1971 Basic Plan for Distribution Systemization, Japan called for the strengthening of information ties as a key element of distribution systemization. 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

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[832]A JFTC study of information networking in the distribution sector noted: "Information networking especially under the sole direction of oligopolistic manufacturers may be considered as a problem which could expand the gap in competitiveness … In particular, in the case that oligopolistic manufacturers use information networks as an integral part of their management of distribution channels, it is feared that the dependence of other information network participants on the network leader for transactions will increase, and that their freedom to conduct business activities will become restricted". Fair Trade Commission Office, Fact-Finding Survey Report Regarding Information Networking in the Distribution Sector, September 1989, p. 57-65. US Ex. 65.

[833]1968 Sixth Interim Report, US Ex. 68-8 and US Ex. 14.

[834]1969 Seventh Interim Report, p. 4. US Ex. 69-4.

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

[836]Ibid., p. 80-81, US Ex. 71-9.

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]".[837]

e. In December 1971, MITI established the "Distribution System Development Centre" ("the Centre")[838] in order to facilitate systemization, including the strengthening of information linkages, in close cooperation between the government and the private sector. The Centre orchestrated the development of standardized state-of-the-art hardware and software and coordinated the standardization of information formats to facilitate computer integration.

f. In 1975, the Centre produced the MITI-commissioned "1975 Manual", which underscored the urgency of developing information links to promote systemization.[839] The Centre also studied distribution in specific sectors, including the film and photographic paper sector, and made further proposals for enhancing systemization.

g. In 1975, the Centre published a study on Fuji's strategy to respond to capital liberalization and the entry of Kodak into the market. The study commented that Fuji had been highly successful at internal computerization and concluded that Fuji's next step was to build a "Total Distribution Management System" to include distributors. The study noted the key role that computer links would play.[840]

h. In 1976, the Centre produced a second study of Fuji's computer system, recommending that Fuji develop information links with the primary photospecialty wholesalers and retailers to strengthen its control over the wholesale distribution channel.[841]

6.381 The United States further submits that MITI continued to actively promote information systemization throughout the 1980s:

a. In 1985, MITI promulgated its "Vision for an Information-Armed Wholesale Industry" ("Vision"), which called for support from the Japanese Government for information networking in the distribution industry, including study groups on developing information systems for the wholesale industry, creation of low interest financing, and intensive financing of computerization of small and medium-sized wholesale industry.[842]

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[837]The Basic Plan for Distribution Systemization, 28 July 1971, US Ex. 71-10, p. 4.

[838]Establishment of 'Distribution System Development Centre' and the Promotion of Distribution Systemization Measures, Tsusansho Koho, 20 December 1971, pp. 5-6, 13-18 US Ex. 71-13. Japan notes that the official English name of this institution is the "Distribution System Research Institute".

[839]"… Thus, in addition to rationalization of transactions and distribution, the camera and film industry must improve its information systems, bringing them to an advanced level". 1975 Manual, US Ex 75-5.

[840]"The building of an information system oriented physical distribution system will serve as the front-line in improving the stability of channels that are centred on the company's primary wholesalers and pursuing the creation of a competitive distribution system". Asada Koji, Special Series - PD Strategy: Distribution System and Distribution Channel (No. 9), Physical Distribution Management, April 1975, pp. 55-61, US Ex. 75-1.

[841]"… (2) The online system has allowed the company to ascertain the status of its internal inventory. In the future an attempt should be made to come closer to a system that enables [the user] to ascertain and control inventory at the distribution stage. (3) Because it is important in managing film inventory, ascertaining the status of inventory at the wholesale and retail stages will also lead to the stabilization of channels centred on exclusive tokuyakuten, and there are great benefits both in information and in physical distribution ..". Yoshioka Yoichi, The Online Inventory Control System at Fuji Photographic Film Co., Ltd., Ryutsu to Shisutemu, July 1976, pp. 61-68, US Ex. 35.

[842]MITI Industrial Policy Bureau, Division of the Information-Armed Wholesale Industry, 14 June 1985, US Ex. 52.

b. In 1986, to implement the "Vision," the Centre issued a report[843] to serve as the "guiding light" for the basic position of the information-armed wholesale industry and oversaw a series of government-industry committees to address the problems identified in the report.

c. In 1987, the "Photography Industry Information Systemization Symposium," i.e., the System Council was established under MITI auspices to standardize the information systemization infrastructure.[844] The System Council focused mainly on the problem of incompatibility of data formats but also conducted yearly studies on the advancement of information systemization in the photography industry.

d. In 1988, the System Council[845] finally solved the problem of incompatibility of computer systems in the photography industry by standardizing the data formats, product codes, and transaction forms across companies that were to participate in a particular information network.

e. In January 1989, the Council issued standard film developing and processing product codes.[846]

f. In February 1989, the Council issued uniform vouchers for use by members of the photography industry.[847]

g. In March 1989, the Council issued "Comprehensive Photo Industry Informization Manual", which served as the industry's reference manual for standardization of information systems.[848]

6.382 According to the United States, as noted by Japan, Fuji finally established on-line connections with its primary wholesalers in 1989.[849]

6.383 **Japan** admits that the 1971 Systemization Report discussed suggestions for standardization of paperwork and distribution, and better information exchanges through the distribution chain and the 1975 Manual expanded on these suggestions in a more detailed manner. However, whatever the advisory councils and public corporations were recommending, Japanese manufacturers in this industry were not paying much attention. Specifically, Japan maintains that the largest Japanese manufacturer in this sector did not finish installing joint computer systems with its wholesalers until 1993, almost 20 years after the recommendations were made.

(g) Current competitive position of imports

6.384 The **United States** emphasizes that Japan's actions to deprive foreign manufacturers access to the wholesale distribution channels have adversely altered the conditions of competition for imported photographic materials. Foreclosure from the wholesale system substantially impairs the ability of imported products to compete by limiting their access to retail outlets, increasing their distribution costs relative to those of domestic manufacturers, and neutralizing vigorous attempts to market

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[843]Distribution Organization Centre, "Research Report on Information Networking in the Wholesale Industry: Toward An Information Oriented Wholesale Industry," March 1996.

[844]Photo Industry Information System Manual (The Fourth Edition), Photo Industry Distribution System Council, April 1996, US Ex. 96.

[845]The System Council was renamed the "Conference for Photography Trade Information Systems" in October 1988.

[846]Saito Seiichi, "Uniform Voucher Policy Facing New Challenges," Ryutsu to Shisutemu, March 1992, pp. 86-97, US Ex. 75.

[847]Ibid.

[848]Photo Industry Distribution Information System Council, Photo Industry Distribution Information System Manual (The First Edition), March 1989, US Ex. 62.

[849]Affidavit of Mr. Tanaka, General Manager, Fuji Photo Film Co., Ltd., Japan Ex. A-10, p. 3-4.

aggressively. Furthermore, market surveys demonstrate that imports have access to only a limited segment of the market, as compared with domestic products.

(i) Primary and secondary wholesale channels

6.385 The United States submits that virtually all domestically manufactured film in Japan flows to *retail* outlets through wholesale channels, while imported film is almost entirely excluded from those channels. Foreign manufacturers sell virtually no film through primary wholesalers. Kodak sells only 15 percent of its film to secondary wholesalers, and Agfa sells no film through secondary wholesalers.[850]

6.386 In the US view, *primary* wholesale channels provide the Japanese photographic film and paper manufacturers with assets pivotal to protecting their dominance of the Japanese market, e.g., access to the customer relationships which the primary photospecialty wholesalers have developed over much of the last century which are a vital element of successfully doing business in Japan. Moreover, through this exclusive access, Japanese film manufacturers have gained unparalleled marketing power and such services as inventory control, after-sales services, sales promotion, and front-line sales personnel. Foreign suppliers must perform such marketing and distribution functions themselves and so are burdened with a higher relative cost structure. Foreign film manufacturers cannot replicate these relationships or provide comparable services in an economically viable manner.

6.387 The United States submits that *secondary* wholesalers support the operations of the primary wholesalers but they cannot substitute for them.[851] Secondary wholesalers are small and regional in their operations and do not have either the scale or the geographic reach of the primary wholesalers. Moreover, Fuji and its primary photospecialty wholesaler control or dominate a number of the larger secondary wholesalers, and are in a position to influence all secondary dealers because of Fuji's status as supplier of the dominant brand.[852] While some secondary wholesalers carry multiple brands of film, most do not, and foreign film is almost as scarce in these channels as it is in primary channels.[853]

6.388 The United States maintains that any foreign manufacturer is disadvantaged in this situation because it would face many of the same obstacles in trying to convert a secondary wholesaler into a primary wholesaler as it would in trying to build a new distribution network from the ground up. These include, e.g., the need to establish relationships with many small retail outlets; the need to establish a personnel base with the necessary technical skills and market knowledge; and the need to develop wholesale supplier relationships with various manufacturers of photographic supplies (cameras, accessories, etc.). Even those secondary wholesalers that will supply multiple brands buy a large share of the film and other products they distribute from the primary photospecialty wholesalers. Were a secondary wholesaler to try to expand its business, it would find itself in direct competition with these primary wholesalers (who also are its suppliers of Fuji film) and attempting to displace primary wholesalers with whom most retailers have longstanding and stable relationships.[854] Moreover, those manufacturers that currently distribute through the primary wholesalers would be unlikely to jeopardize

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[850]Photo Market 1996, US Ex. 96-1.

[851]In response to Japan's argument that secondary wholesalers provide the key to accessing small retail outlets, the US argues that Japan has provided no supporting evidence and that only about one-third of Fuji's film sales go through secondary wholesalers to the retailers, while the majority goes directly from the primary wholesalers to the retailers. US Ex. 96-1, p. 132.

[852]Affidavit of Sumi Hiromichi, 27 November 1996, US Ex-96-10.

[853]Foreign film accounts for only 7 percent of the film sold through secondary channels. Photo Market, 10 June 1996, pp. 132-133 and 254, US Ex. 99.

[854]The stability of these ties is apparent from the constant share of Fuji film sales through primary and secondary wholesalers since 1980. While Kodak's film sales through the various distribution channels changed in accordance with its changing market strategies, Fuji's sales through primary wholesalers have remained at exactly 59 percent since 1981 and its sales through secondary wholesalers have remained at exactly 33 percent since 1980, according to *Photo Market*, the standard Japanese statistical publication for the photography sector.

their relationships with these primary wholesalers by selling their products to an upstart primary wholesaler. Finally, the existing primary photospecialty wholesalers achieve efficiencies (i.e., "economies of scope") by delivering cameras and a wide variety of other photospecialty products beyond film and paper. A foreign film and paper manufacturer building a new distribution system from the ground up would not have the benefit of such efficiencies. Thus, the United States alleges that for a foreign manufacturer it would be impossible to establish the customer base to achieve the economies of scope necessary to make its operations economically viable.

(ii) Current market structure in the distribution system

6.389 For **Japan**, the core of the US allegations regarding distribution policies is the claim that single-brand distribution in Japan impedes market access for foreign brands of film and paper and that it is impossible for a foreign manufacturer to sell directly to all the 280,000 outlets that sell film in Japan. To gain access to those outlets, according to Japan, the United States claims that it is necessary to sell through national wholesalers, such as the primary wholesalers of the domestic manufacturers. Japan disagrees with this characterization because Kodak, the leading foreign manufacturer, does not sell directly to Japanese retail outlets. Similarly to Fuji and Konica, it sells through a national wholesaler. Kodak's national wholesaler, Kodak Japan, just happens at present to be a wholly owned subsidiary. In the past, it was a Japanese company, Nagase, and then a joint venture with Nagase.

6.390 The **United States** responds that Kodak does business in Japan 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, whereas that fact does not make it a "wholesaler".

6.391 **Japan** responds that Kodak transfers its film to Kodak Japan, which then sells the film to the very same secondary wholesalers and retailers. Kodak thus distributes its film very successfully through a parallel sales channel to Fujifilm. In Fujifilm's case, the independent primary wholesalers transfer the film from Fujifilm to their customers. For Kodak, Kodak Japan transfers the film from Kodak to the very same customers. Thus, Kodak Japan performs the same function as Fujifilm's primary wholesalers. Japan also notes that the United States confuses Kodak Japan and Eastman Kodak Japan. Although Eastman Kodak Japan provides both marketing and technical services, and is not a wholesaler, Kodak Japan functions as a primary wholesaler.

6.392 Japan emphasizes that no national wholesaler of any manufacturer sells to all 280,000 outlets, or to anything close to that number. Fuji's primary wholesalers sell to a combined total of fewer than 5,000 accounts. Most of these accounts are large retailers; about 300 are secondary wholesalers and photofinishing laboratories that resell film on a regional basis to the hundreds of thousands of remaining retail outlets.

6.393 The **United States** contends that even if these numbers were correct, Fuji needs the four large primary wholesalers to service these 5,000 accounts. Because the foreign manufacturers have no access to these primary photospecialty wholesalers or to many of the secondary wholesalers that service these accounts indirectly 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 of large cities, where photospecialty outlets are relatively large and densely located.

6.394 In **Japan's** view, the primary wholesalers do not provide the key to accessing large numbers of small retail outlets because that is the function of secondary wholesalers, and they typically carry

multiple (including imported) brands.[855] The primary wholesalers, like their counterpart Kodak Japan, sell mainly to larger volume retailers. The degree of overlap is high given that nearly 90 percent of Fuji's sales volume goes to accounts that either carry Kodak film or have an existing business relationship with a Kodak supplier. Thus, Japan concludes that there is no "distribution bottleneck".

6.395 The **United States** responds that these figures vastly overstate the availability of Kodak film in the Japanese market. A Fuji survey finds that 62 percent of the primary wholesalers' customers currently carry Kodak film. This figure includes any outlet even if it carries only a token amount of Kodak film and counts all outlets in a chain even if only one outlet in that chain carries Kodak film. In order to obtain the "nearly 90 percent" figure, Japan adds Fuji's primary wholesalers' customers that do not carry Kodak film but do business with sellers of other Kodak products. The figure therefore includes all outlets served by a secondary wholesaler affiliated with one of Fuji's four primary wholesalers if that secondary wholesaler sold any other Kodak product, even if neither the primary nor secondary wholesaler was willing to carry Kodak film. The United States refers to an associated Fuji survey that was conducted of film availability at the retail level. A US analysis of this survey, from which the 90-percent figure is allegedly derived, shows discrepancies between the actual survey results and the figures reported by Japan.[856] The United States further argues that inspection of the Fuji survey also reveals that it used biased survey and sampling techniques. The Fuji survey is limited to six major metropolitan areas. There is ample evidence that the film market in Japan is not homogeneous and that foreign film is more available in major metropolitan areas than other areas.[857]

6.396 **Japan** responds that the United States' attack on these survey results reveals its own confusion. 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.[858]

6.397 The **United States** emphasizes that the Kodak survey shows that Kodak film is actually available in about 40 percent of the stores in Japan. Kodak's survey design, which utilized well-accepted statistical sampling methodology, was based on the method used for Japan's National Survey of Prices. A total of 2,028 outlets in 144 cities and 45 of 47 prefectures were randomly surveyed in proportion to their share of film sales. For example, approximately half of the film sold in Japan is through photospecialty stores, so half of the outlets surveyed were photospecialty stores. The results were then weighted by film sales by prefecture because actual sales data by store are not publicly available.

6.398 According to **Japan**, historically, single-brand distribution did not stop foreign market share of colour film from doubling from 1970 to 1981 (from 10.1 to 20.0 percent), and foreign market share

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[855]According to Japan, in a survey of the 278 secondary wholesalers that carry Fuji brand film, 62.0 percent of the outlets representing 77.3 percent of the volume of film being sold carried at least one foreign brand of film.

[856]The United States notes that a review of the survey forms provided by Japan in response to the US request showed that 2,061 stores were surveyed, not 1,966 stores as claimed by Japan. Furthermore, stores were surveyed in nine different prefectures, not six cities is claimed by Japan. Japan claimed that the random sample included 600 photospecialty stores and 114 supermarkets, but on examination the United States found that the random sample instead included 609 stores of at least 10 different outlet types. Finally, the statement that "the number of samples was determined in proportion to its sales share in the film market" was found to be inaccurate. For example, 26 percent of film sold in Japan is sold in stores in the supermarket-department store category; however, only 10 percent of the outlets in the Fuji survey were of that type. Convenience stores sell approximately 8 percent of the film in Japan, but 19 percent of the stores surveyed by Fuji were convenience stores, Survey on Film Retail Outlets, 1997, Japan Ex. C-22.

[857]According to the United States, fewer than one third of the survey's 2,061 outlets were randomly surveyed. Thus, Fuji's "random sample" was drawn in a manner which would systematically bias upward the reported availability of Kodak film.

[858]In Japan's view, the United States appears to confuse the exhaustive survey of the wholesalers' customers with the sampling done for the retail availability survey. Japan responds to US allegations about the sampling techniques of the retail availability survey in Japan Ex. F-7.

of black and white film from surging more than six-fold from 1970 to 1985 (from 6.6 to 41.4 percent). At present, single-brand distribution has not prevented foreign consumer film from extensive penetration of distribution channels. Accordingly, 62 percent of the customers buying from single-brand wholesalers of Fuji brand film, representing 77 percent of sales volume, already carry Kodak brand film, obtained from other channels. Furthermore, Japan emphasizes that there are no governmental or legal barriers to domestic manufacturers' primary wholesalers carrying competing brands if they thought it to be in their business interest to do so. Japan concludes that the government did not create the market structure, and the market structure has not limited opportunities for foreign consumer photographic products.

6.399 Japan contests the US allegation that cutting prices "could bring automatic scrutiny". Japan contends that, while the United States underscores Kodak's efforts to cut prices, it does not identify a single instance of Japanese Government intervention to discourage Kodak from offering low prices. The only scrutiny of prices was and remains scrutiny by the JFTC of parallel and simultaneous price increases by all manufacturers, domestic and foreign, in the Japanese market.

(iii) Vertically integrated distribution system

6.400 According to the **United States**, the Japanese Government and Japanese analysts have frequently acknowledged that manufacturer-dominated distribution *keiretsu* operate to the advantage of the dominant manufacturers and limit competitors' access, including access of foreign firms. The JFTC's 1992 study of highly oligopolistic industries concluded that manufacturer-dominated distribution systems "may serve a means for competitive obstructionist acts of exclusionary behaviour".[859] A 1989 study by the Institute for Distribution Research observed that "once keiretsu-ka has been established, it can give the impression of [a distribution system that is] inflexible and closed. Many foreign firms, especially, have seen it as a problem with the distribution system in general".[860] The Economic Planning Agency concluded in a 1989 study that Japan's distribution system with keiretsu-nized channels was "hindering the import expansion" and "if the foreign businesses contract their own marketing channels, initial cost for participating in our nation's market will be excessive".[861] The United States quotes a former member of MITI's Industrial Structure Council who commented that "policies … protecting small distributors … are competition controlling policies [which] maintain the distribution system which is closed to foreigners".[862]

6.401 **Japan** responds that the United States struggles to develop a logical link between MITI distribution policies and incentives to vertically integrate for a simple reason: the documents themselves do not talk directly about any intent to encourage vertical integration. 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. Japan calls attention

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[859]The study observed film that "Fuji Film has contracts with seven stores; four of the *tokuyakutens* are essential and operate on a national scale". JFTC Economic Research Survey Council Report, The Competitive Situation in Highly Oligopolistic Industries, August 1992, US Ex. 92-4, p. 28.

[860]Distribution Problem Research Council, Report on the Seventh Distribution Problem Research Committee Meeting, 1989, US Ex-63.

[861]"Distribution keiretsu-nization achieves channel control and organizes the distribution route by creating a long-term and fixed trade relationship with the distributor in order for the manufacturer to develop the marketing strategy effectively.…[I]n a keiretsu-nized channel, these are cases in which imported products are difficult to handle due to fragmentation of the chain stores, etc., and this means that existing marketing channels cannot be used by the foreign businesses. Economic Planning Agency, Planning Bureau, Research Related to Imports and Prices, 1989 Report, p. 8, US Ex 89-1.

[862]Miyashita Masafusa, 4. Problems in the Wholesale Industry and Direction for Reinforcing Functions, Henkakuki no Ryutsu (Distribution in Transition: Strategic Challenges for a New Era). Edited by Yoshihiro Tajima, 22 November 1991 pp. 69-80, US Ex. 72.

to the Sixth Interim Report in 1968, which continues to see vertical integration as a problem. The report notes the importance of maintaining a balance of power throughout the distribution chain:

> "In addition, it is desirable that situations in which one party in distribution activity is subordinate to the others, and its development hindered, should be eliminated as much as possible, and that commercial activity should be conducted on the basis of fair negotiations between the parties. Great importance should be attached to the fact that, if such a balance of power is realized, even if more powerful enterprises and organizations emerge at the production distribution or consumption stage, other stages will act to counter [such counter influences] and will fulfill the function of preventing harmful effects".[863]

In Japan's view, recognizing the trend toward vertical integration, the report discusses both its advantages and disadvantages.

(iv) Alternative distribution policies

6.402 The **United States** notes that Kodak attempted to find a route to market around the closed wholesale distribution channels, but with only limited results. Kodak has aggressively sought to expand *film* sales through the photofinishing laboratory channel, but is only able to sell about one-quarter of its film through this channel. Moreover, 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.[864]

6.403 **Japan** responds that Kodak has a network of affiliated laboratories just like the domestic manufacturers. Moreover, approximately 60 percent of total paper sales in Japan are to minilaboratories, which exist completely outside the "captive market" complained about by the United States.[865] Japan also notes, quoting an industry report,[866] that affiliations between manufacturing and photofinishing laboratories are common around the world.

6.404 According to the **United States**, Kodak has sought to compete on the basis of price and product innovation seeking to both gain access to the primary wholesale channels and establish alternative routes to the market.[867] However, there was a negative correlation between Kodak's wholesale price reductions and its share of domestic sales, which declined slightly during the same period. Furthermore, Kodak introduced a variety of innovative products with no competitive Japanese counterparts and undertook aggressive marketing campaigns.[868] Contrary to Japan's argument that Fuji and Konica spent 18 times the amount of foreign brands on advertising,[869] the United States point out that the *Economist* estimates that Kodak's advertising expenditures in Japan were triple those of the Japanese manufacturers combined during the 1980s, the period cited by Japan.[870]

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[863]Sixth Interim Report, p. 10-11, U.S. Ex. 68-8.

[864]Affidavits of Sumi Hiromichi, US Ex 96-10 and William Jack, US Ex. 97-2.

[865]See also sub-section V.A.3.(e) on "The market for paper" above, in particular para. 5.67.

[866]1993-1994 International Photo Processing Industry Report, p. 7-2, Japan Ex. B-54.

[867]According to the United States, Kodak lowered prices by 56 percent during the period of 1986-1995, further widening the already sizeable gap between its wholesale prices and those of the Japanese manufacturers.

[868]The US states that the impact of advertising is typically evaluated not only by money spent, but by the extent to which brand recognition is increased. Kodak has focused on advertising campaigns that would most increase its brand recognition.

[869]Yuryoku Kigyo no Kokoku-Senden-Hi (Advertising Expenses of Major Companies), Nikkei Kokoku Kenkyusho, December 1974 - September 1994, Japan Ex. A-7.

[870]The Revenge of Big Yellow, Economist, 10 November 1990, p. 2.

6.405 **Japan** notes that Kodak has been telling retailers that it would like Kodak film to have exactly the same price as Fuji brand film.[871] Japan also notes that during most of the late 1980s, Kodak was simply unwilling to compete based on price. This empirical reality can be confirmed by statements by Kodak management. Kodak officials have made repeated public statements over the past decade to the effect that Kodak had no intention of attempting to gain market share in Japan through underselling domestic brands. In 1986, as the yen was appreciating rapidly, then Kodak Chairman Kay Whitmore made clear that Kodak would not take advantage of this exchange rate shift to undersell domestic brands:

> "The President ruled out the possibility of the company passing on exchange gains from the yen's appreciation against the US dollar to Japanese consumers in the form of lower prices. He said Kodak is not a price leader in Japan and had no intention of lowering its prices to win in competition with its Japanese rivals".[872]

6.406 The **United States** also submits that Kodak has invested heavily in Japan, establishing Kodak Japan in 1977 - less than a year after photographic materials manufacturers were permitted to own 100 percent of a new enterprise - to provide technical and marketing services. Kodak as well as Agfa also have repeatedly sought to reestablish ties to the four primary photospecialty wholesalers without success.[873]

6.407 **Japan** responds that the real story of the liberalization of investment in the Japanese film industry is that of Kodak missing opportunities to expand its presence in the Japanese market. As a result of Japan's capital liberalization policies, Kodak had many opportunities to invest in Japan. However, with the exception of a small liaison office established in 1977, Kodak made no effort to establish a presence in Japan until 1986. At this time, 15 years after the onset of capital liberalization, Kodak announced that it would expand its presence in Japan through a joint venture with Nagase to serve the Japanese photographic marketplace directly. Thus, the timing of capital liberalization for photographic materials sector thus had no impact on Kodak's investment plans during the 1970' s because Kodak had no investment plans during this period.

(h) Change in distribution policies

6.408 With respect to the US allegation that MITI's distribution policies established less favourable competitive conditions for imported film and paper, Japan responds that what matters is whether competitive conditions *today* are less favourable than those *at the time of the relevant tariff concession*.

6.409 Japan notes that even assuming that MITI's alleged distribution policies or its effects continue to the present day, there has been no material adverse change in the Japanese market structure for film or paper since 1967, and no adverse change since 1979 or 1994. The trend toward single-brand distribution of film began far in advance of 1967, and affiliations between film manufacturers and photofinishing laboratories were already common by then as well. The alleged measures that occurred after 1967 such as the 1970 Guidelines were, according to the United States' own argument, merely continuations of pre-existing policy. Japan further points out that in its discussion of the Tokyo Round claims, the US makes only allegations about the "promotion countermeasures" and the Large Stores Law, but the US does not even make allegations about "distribution countermeasures" with regard to the Tokyo Round. Japan concludes that without any material adverse change in government policy, there can be no upsetting of the competitive position and hence no nullification or impairment.

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[871]See sub-section V.A.2. on "The development of the Japanese film market" above, in particular para. 5.31.

[872]Kodak Intends to Establish Stronghold in Japan: Pres. Whitmore, Jiji Press Ticker Service, 26 August 1986, Japan Ex. A-21.

[873]WTO GATT Affidavit, Albert L. Silg, Former President, Kodak Japan Ltd., 9 January 1997, and WTO GATT Affidavit, William Jack, Manager of New Business Development, Consumer Imaging, Eastman Kodak Company, 13 February 1997, US Ex. 97-1 and US Ex. 97-2.

(i) 1990 Guidelines

6.410 In Japan's view, to the extent MITI's distribution policies have changed since 1967 or 1979, the change has been favourable for the competitive position of imports. Specifically, MITI's 1990 Guidelines, which remain in effect today, are explicitly committed to encouraging changes in distribution practices to render the Japanese market more accessible to imports. According to Japan, the United States as part of its deregulation proposals recently urged Japanese industry to adhere to those guidelines.[874] Since 1994, the United States has not identified or even alleged any change at all in MITI's distribution policies. In light of these facts, Japan concludes that the distribution policies in effect today do not establish conditions of competition less favourable for imports than those established by the distribution policies of 1967, 1979, or 1994.

6.411 Japan points out that the 1990 Guidelines addressed exactly the same kinds of "irrational" business practices as those targeted by the 1970 Guidelines, e.g., rebates, returns and dispatched employees. However, for the 1990 Guidelines, encouragement of imports was the guiding purpose for targeting these practices, given that they had their origin in the US - Japan Structural Impediments Initiative ("SII")[875] at the direct request of the United States to render the Japanese market more accessible to imports. In 1996, the US requested Japan to ensure adherence of the its business community to these guidelines.[876]

(ii) Business Reform Law

6.412 The **United States** submits that when the *Uruguay Round* ended, the exclusionary distribution system that Japan had orchestrated after the Kennedy Round, together with the Large Stores Law and the promotion countermeasures, were completely embedded in the Japanese market and were continuing successfully to impede market access for imported products like photographic film and paper. Nevertheless, Japan enacted yet another measure to ensure that any tariff concessions negotiated during the Uruguay Round would be offset, as had those of the Tokyo and Kennedy rounds.

6.413 According to the United States, in 1995, the Japanese Diet enacted the Special Measures Law to Promote Business Reform for Specified Industrialists (Business Reform Law).[877] The law is intended to facilitate "reforms" by businesses in MITI-designated industries, which are being affected by the diversification and structural changes in the domestic and overseas economic environment.[878] The Business Reform Law contains a focus on *domestic* production activities[879] in relation to "new systems concerning the distribution of products".[880] The law authorizes a broad range of assistance to businesses that are part of a designated industry, including: (i) preferential financing; (ii) tax incentives; (iii) domestic and foreign business intelligence; and (iv) potential exemptions from the Antimonopoly

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[874]Japan notes again that this US request to encourage compliance with the 1990 Guidelines occurred after the US panel request in this case.

[875]"As to trade practices concerning distribution, an improved environment will be sought from the standpoint of promoting competition and securing market openness". Final Report of the Japan - US Structural Impediments Initiative, Actions on Government of Japan Side, 28 June 1990, p. III-1, Japan Ex B-30.

[876]"Monitor and report on adherence by the Japanese business community to the MITI 1990 Guidelines on Business Practices in order to promote a free, transparent, and competitive distribution system". Submission 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.

[877]Special Measures Law to Promote Business Reform for Specified Industrialists, Law No. 61, 1995 [Jigyo Kakushin No Enkatsuka Nikansuru Rinji Sochi Ho] (Business Reform Law), US Ex. 95-1.

[878]MITI Industrial Structure Division, Commentary on the Business Reform Law, Article I of Business Reform Law, US Ex. 95-4.

[879]Ibid.

[880]Ibid., p. 13, US Ex. 95-4.

Law.[881] To date, MITI has designated 165 industries as eligible for assistance under the Law, among them "Manufacturers of Cameras and Accessories"[882] and "Retail Business of Cameras and Photosensitive Materials".[883] The US' current understanding is that MITI has neither received nor approved a business reform proposal related to the photographic film and paper industry.

6.414 In view of the broad grant of authority represented in the Business Reform Law, the statements by MITI officials concerning their intended application of the law, and Japan's actions over the last 30 years in restricting import access into this sector, the United States has serious concerns that its zero-tariff bindings, which represent the culmination of negotiations over three multilateral trade rounds, are at risk. In the particular context of government-business relations in Japan, the enactment of the Business Reform Law, and the designation of this sector as one eligible for assistance, have already sent a signal that the Japanese Government is prepared to continue its support of this sector. The United States does not allege at this time that the Business Reform Law has already nullified or impaired tariff benefits that the United States reasonably expected in connection with Japan's Uruguay Round tariff concessions on photographic film and paper. But the clear potential exists for this law to be used to reinforce or supplement the other measures of protection that Japan has implemented in this sector.

6.415 **Japan** responds that the US description of the Business Innovation Law (the "Business Reform Law" as referred to by the United States) is misleading. The law's fair treatment of domestic and foreign enterprises and products is evident not only from the content of the law, but also from the fact that several foreign-affiliated companies have received benefits under the law. Japan notes that the law was never applied to the photosensitive materials retailing sector (the only eligible sector under the law which related to film and paper) and as a result of a regular revision of the coverage of the eligible sectors, even that sector is no longer an eligible sector. Moreover, Japan emphasizes that the United States specifically refrained from making any legal claims regarding this law.

4. RESTRICTIONS ON LARGE RETAIL STORES

(a) General overview of the allegations

6.416 The **United States** claims that the suppression of large stores under the Large Stores Law affects the distribution of foreign film in Japan in two respects: First, the restriction of large stores indirectly supports manufacturer domination of oligopolistic distribution structures. This structure depends on manufacturer dominance of wholesalers, and wholesaler dominance over retailers. The United States argues that retailers with greater purchasing power and business sophistication could effectively play the various wholesalers and manufacturers off of each other to gain more favourable terms, and to resist attempts to hold the retailers under the control of a single manufacturer-wholesaler chain. Second, the United States asserts that large stores provide an alternative channel to market for foreign manufacturers excluded from the wholesale distribution system. With a sufficiently developed network of large stores, a manufacturer could reach a large portion of the Japanese market with a limited number of accounts.[884] Consequently, the United States claims that Japan upset the competitive relationship between imported and domestic photographic film and paper by inhibiting the development of a viable alternative channel for the distribution and sale of imported film and paper.

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[881]The United States explains that in order to receive assistance, a business in a designated industry must submit a business reform plan to the competent ministry (e.g., MITI) which must approve the plan. Assistance is available for retooling, restructuring, expanding or contracting operations, or making additional capital investment at greatly reduced costs.

[882]Designation number 123, MITI Ministerial Order No. 31, 1995.

[883]Designation number 164. MITI Ministerial Order No. 31, 1995. The list of 165 industries is provided for under Article 2 Clause 1 of the Business Reform Law.

[884]E.g., Agfa sells about half of its film in Japan to a single store chain, Daiei, Japan's largest supermarket.

6.417 With respect to the *Kennedy Round*, the United States submits that at the same time when Japan closed off the primary Japanese distribution channels as the traditional routes of distribution to imported photographic film and paper, it began taking steps to control the growth of large stores. According to the United States, between 1968 and 1971, MITI limited the growing number and commercial viability of large stores by issuing administrative guidance with a view to:

(i) expanding and strengthening the application of the existing Department Store Law to types of stores not within the law's legislated scope;
(ii) imposing prior notification requirements;
(iii) establishing adjustment procedures to reduce the size of proposed or expanding stores; and
(iv) limiting certain retailer activities such as advertising, bargain sales and pricing, and hours of operation.

6.418 In 1973, the Diet approved the Large Stores Law which became effective on 1 March 1974.[885] Under the law as it was first enacted, builders and retailers of stores larger than 1,500 square meters were required to notify MITI prior to the completion of construction or the opening of a large store. If MITI determined that the store risked causing a significant impact on local small and medium-sized retailers, it could subsequently adjust:

(i) the size of the store;
(ii) the opening date;
(iii) the number of holidays; or
(iv) the hours of operation.

6.419 The United States alleges that the enactment of the Large Stores Law resulted in fewer large retail stores, stores of smaller size, and substantial delays in large store openings or expansions.[886] This in turn resulted in significant limitations on the opportunity for imported products to penetrate the Japanese market through large stores. According to the United States, large stores were extremely valuable to foreign film and paper manufacturers because large stores:

(i) have the potential to serve as an alternate route to distribute imported film;
(ii) have more shelf space to carry secondary and tertiary brands, including imports;
(iii) typically purchase directly from the manufacturer, not from primary wholesalers; and large stores have the capacity to act as secondary wholesalers.

6.420 Therefore, the United States claims that by reducing the aggregate size and efficacy of large stores, Japan upset the competitive relationship between imported and domestic products and, in conjunction with the other countermeasures, effectively neutralized any beneficial impact that Japan's Kennedy Round tariff concessions had on US exports of film and paper products to Japan.

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[885]According to the United States, the Diet acted upon advice by the Distribution Subcommittee's Tenth Interim Report which recommended replacing the Department Store Law with a new law that would apply to all stores of a specified size, regardless of store type. Industrial Structure Council, Distribution Committee, Retail Business Under Distribution Reforms, The Direction of Revising the Department Store Law (Tenth Interim Report), November 1972, US Ex. 72-3.

[886]Frederick Nagai: Affidavit, pp. 2-4, US Ex. 97-8. The MITI Vision for the 1990's stated that under the Large Stores Law, "there have been … instances in which the adjustment process has been needlessly prolonged". After the Implementation of the "Large Store Law" Consistent Results from Time Restrictions, Camera Times, 11 May 1976, p. 5, US Ex. 76-3. After the Large Stores Law was enacted in 1974, the number of applications for "large stores" declined steadily over the five-year period 1974 to 1978 (with the exception of a temporary increase in 1977) to well below the 1974 level.

6.421 With regard to the *Tokyo Round*, the United States submits that, on 11 May 1979, exactly one month before the formal end of the negotiating round, Japan implemented an amendment to the Large Stores Law[887] and MITI issued several directives. These amendments:

(i) dramatically expanded the scope of the Large Stores Law which previously had covered stores of 1,500 square meters or more by extending it to cover stores as small as 500 square meters;
(ii) delegated to the prefectural governors responsibility for regulating large stores between 500 and 1,500 square meters; and
(iii) gave small and medium businesses a more significant role in the formal review process by requiring that builder notifications be submitted 13 months prior to the proposed building completion date during which time the builder, proposed store operator and local businesses would engage in an "informal adjustment process" to negotiate changes in the notification.[888]

6.422 The United States further explains that in January 1982, MITI gave guidance to prefectural governors discouraging acceptance of any notifications in areas having a "high level" of stores larger than 1,500 square meters or defined as "small in scale".[889] At the same time, MITI introduced a requirement that builders provide a "prior notification explanation" to the affected community before attempting to submit a notification to MITI.

6.423 According to the United States, the post-Tokyo Round changes to the Large Stores Law had two primary effects. First, the period of time between notification and the completion of the adjustment process increased significantly. Second, small and medium retailers took full advantage of the "pre-notification explanation" and "informal adjustment" processes to extract adjustments that would not be realized through the formal adjustment process.[890] The United States claims that, as a result, the number of large store notifications declined sharply notwithstanding that the amended law regulated stores of much smaller size than the law as originally enacted. This in turn upset the conditions of competition between imported and domestic photographic film and paper. The United States stresses that MITI's strengthening of the Large Stores Law was so effective that retailers attempted to circumvent it by merging with other retailers to avoid the inevitable difficulties and delays involved in trying to open a new large store or expand an existing large store. In July 1981, the JFTC issued special Retail Merger Guidelines that applied a highly restrictive market definition which had the effect of impeding retailers from using mergers to avoid the Large Stores Law.[891]

6.424 In the US view, the regulations on large stores significantly limited the opportunity for imported products to penetrate the Japanese market through large stores. This was accomplished by further

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[887]The United States notes that the amendment to the Large Stores Law was passed in November 1978, but did not become effective until May 1979. The United States and Japan concluded their substantive Tokyo Round negotiations on many products, including film, in the summer of 1978. Letter to Walter Fallon, President of Kodak, from Deputy Trade Representative Alan Wolff of 30 August 1978, US Ex. 78-6.

[888]MITI Directive Nos. 365 and 366, 11 May 1979, US Ex. 79-2 and 79-4. The prior adjustment step increased the restrictiveness of the adjustment process by providing an unofficial forum not attended by any Large Scale Store Council officials in which local retailers could levy demands upon large scale stores. Because officials at the formal adjustment stage required consensus from prior adjustment in order to approve an adjustment plan, this process resulted in agreements and memorandums of understanding that severely limited the competitiveness of large scale stores. Agreements reached pursuant to the informal adjustment process were presented in the formal adjustment process and were used in developing the Large Store Council's recommendations to MITI for the reduction in store size, delay in opening date, and changes in closing times and number of holidays.

[889]MITI, Industrial Policy Bureau, Immediate Measures Regarding Notification to Establish Large Scale Retail Stores, Policy Bureau No. 36, 30 January 1982, US Ex. 82-2.

[890]E.g., price restraints and promises not to enter into certain product lines or services.

[891]Retail Merger Guideline (extract): Administrative Procedure Standards for Examining Mergers for Transfers of Business in the Retailing Sector, 24 July 1981, US Ex. 81-6.

reducing the aggregate size and efficacy of large stores as an alternative channel for the distribution and sale of imported film. In the absence of the government's regulation of large stores, imported film would have had substantially greater opportunities for distribution and sale in the Japanese market following the Tokyo Round.[892] The United States claims that the Japanese Government imposed these measures to neutralize the ability of foreign producers to capitalize on the market opportunities that they legitimately anticipated would emerge following the tariff concessions that Japan made during the Tokyo Round and thus nullified and impaired the benefits of those concessions within the meaning of Article XXIII:1(b).

6.425 As to the *Uruguay Round* negotiations, according to the United States, at that point Japan's trading partners knew that the Japanese market was difficult to penetrate, but the way in which the Large Stores Law worked in concert with the distribution countermeasures and promotion countermeasures to systematically offset tariff concessions for photographic film and paper was not known. The United States claims that this web of liberalization countermeasures has continued to operate to nullify or impair US benefits, inter alia, due to the sharp diminution of alternative channels to primary wholesale channels of distribution.

(b) Effect of the Large Stores Law on imported products

6.426 **Japan** argues that in a non-violation case the complaining party must show how the "application" of a measure to specific products nullifies or impairs benefits with respect to those products. Since the benefit consists of legitimate expectations concerning the competitive opportunities for imported products, it follows that for a measure to nullify or impair that benefit, it must "apply" to the products in question.[893]

6.427 Japan notes that in the present case the United States bears the burden to show specifically how the application of the Large Stores Law to the specific products at issue, i.e., black and white film and paper, and colour film and paper, nullifies or impairs some benefit. Japan maintains that the law and its implementing regulations neither apply directly to film or paper, nor to any product generally.

6.428 Further, Japan submits that the law does not distinguish between domestic and imported film and thus there is no explicit disadvantage imposed on imports. Furthermore, the regulation of large stores under this law also does not impose any inherent disadvantage on imports and there is nothing intrinsic in the nature of imports that renders them less capable of competing in a marketplace where a diversity of retailing types is promoted.[894] Accordingly, the law cannot be upsetting the competitive position of imported photographic film and paper.

6.429 Moreover, Japan points out that the Large Stores Law does not vest the government with the authority to recommend or order any store to carry certain products or products of a certain origin.[895] In addition, the regulations imposed by the law on large stores do not depend on the origin of products carried by large stores or small retailers within their vicinity. Thus, the law does not create any artificial incentive for retailers to buy domestic film, nor does it discourage retailers from buying imported film. For Japan, there is thus no reason to believe that larger retail space inherently works to the advantage

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[892]The United States notes that from 1990 to 1992, Japan made a number of changes to the law, purportedly to reduce its adverse impact on the operation of large stores. As the 1995 JFTC Study documents, however, these amendments failed to alleviate the major restrictive impact of the law.

[893]Japan recalls that all previous findings concerning non-violation complaints have addressed only two specific type of measures: product-specific subsidies and tariffs, which have been clearly "applied" to the products in question.

[894]See *United States - Automobiles*, GATT Doc. DS31/R, para. 5.14.

[895]Japan claims that the only distinction the law draws with respect to products is to apply more liberal rules with respect to retail stores that carry imported products.

of imported film products, because retailers choose products to maximize profit, and the size of retail space does not change the profitability of film products to the advantage of domestic brands. Accordingly, the law is thus incapable of altering even indirectly the competitive conditions between domestic and imported products.[896] Japan concludes that it is not possible for this law to frustrate any reasonable US anticipation concerning specific products at the time of any of the relevant tariff concessions.

6.430 The **United States** points out that it has been established under GATT jurisprudence that investment measures can "affect" trade in goods within the meaning of Article III, and therefore are not exempted from being the subject of dispute settlement. The panel on *Canada - Administration of the Foreign Investment Review Act ("Canada - FIRA")* found that provisions in Canada's investment law had a direct impact on trade in goods.[897]

> "… the Panel could not subscribe to the assumption that the drafters of Article III had intended the term "requirements" to exclude requirements connected with the regulation of international investments and did not find anything in the negotiating history, the wording, the objectives and the subsequent application of Article III which would support such an interpretation".

The United States emphasizes that the *Canada - FIRA* panel made clear that it was examining the challenged practices under the FIRA "solely in the light of Canada's "trade obligations" under the General Agreement".[898]

6.431 **Japan** responds that the *Canada - FIRA* panel's holding was quite narrow and provides an important benchmark for a comparison with the broad measures at issue in this dispute. Specifically, Japan notes that the panel's consideration was limited to investment measures that were conditional upon the purchase and export of origin-specific products. Thus, the Canadian measures were not broad, facially neutral requirements like the Large Stores Law, but rather origin-specific requirements pertaining to products which happened to manifest themselves as conditions to more broad investment requirements.

6.432 The **United States** further submits that previous panels found that a measure may be inconsistent with Article III:4 if it affects the distribution of products, regardless of whether the measure "directly governs" treatment of products, or rather regulates service providers and does not directly regulate products.[899] In the view of the United States, the standard certainly should be no higher under Article XXIII:1(b), where the issue is whether there is nullification or impairment of benefits "as the result of … the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement".

6.433 **Japan** recalls that in the context of Article III, the United States itself has argued that "governments make regulatory distinctions for many reasons that have nothing to do with trade protection" on specific products. Japan mentions that in its submission in *Japan - Taxes on Alcoholic Beverages* case, the United States commented on broad based laws that may affect the distribution of foreign origin goods, and argued that these types of laws should not violate Article III simply because

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[896]Large Scale Retail Store Law, Article 7, Japan Ex. C-1. (Deliberation Procedures, Section I, Japan Ex. C-4). Japan notes that the United States has not challenged this characterization and rather seems to claim that large stores favour foreign products while smaller stores carry more domestic film because of the allegedly exclusive distribution network for film.

[897]Adopted on 7 February 1984, BISD 30S/140, 161, para 5.12.

[898]Ibid. p. 157, para. 5.1.

[899]See also Panel Report on *Canada - Certain Measures Concerning Periodicals*, adopted 30 July 1997, WT/DS31/R, p.2, paras. 5.13-5.19. (Panel found that measure could be covered by Article III whether or not GATS could also apply to that measure).

of a disproportionate impact. In particular, the United States hypothetically examined Sunday retail closing laws, which are very similar to the Large Stores Law at issue here:[900]

> "Many jurisdictions have adopted Sunday closing laws, which disproportionately affect supermarkets and other large retail businesses which distribute goods of foreign origin. These stores sell exactly the same products on Sunday and on the other days of the week. We doubt that such measures should be deemed to be violations of Article III simply because of the disproportionate impact of Sunday closing laws on imports".

6.434 Japan also recalls that in the context of Article XXIII:1(b) the United States argued before the panel on *EEC - Oilseeds*: "The United States did not consider that any change in governmental policies, even if it has harmful trade effects, constitutes non-violation nullification or impairment".[901] The United States then went on to give the specific example that a change in income tax rates would fall outside Article XXIII:1(b).[902] In Japan's view, the Large Stores Law is indistinguishable in terms of its nature from the example of a change in income tax rates cited by the United States. Even if people with higher income tend to purchase more imported products, the introduction of progressive income tax rates would not be actionable under Article XXIII:1(b), despite the greater impact on those who tend to buy more imported products. Japan contends that the Large Stores Law does not regulate any of the specific products at issue here, i.e., black and white or colour film and paper. Whereas GATT disputes have traditionally focused on how specific measures affect specific products, the law in question in this case does not draw distinctions with respect to film or paper, or even mention them. Accordingly, Japan concludes that the Large Stores Law cannot upset the competitive position of imported products within the meaning of Article XXIII:1(b).

6.435 Japan suggests that under the overbroad US theory of Article XXIII:1(b), virtually every form of government policy would become actionable as measures potentially relating to specific products. For example, all restrictions on investment would become actionable, because investment could relate to efforts to sell products. Japan believes that a clear nexus must exist between specific products and the challenged government measure, and that the US allegations concerning the Large Stores Law do not meet this test.

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[900]Panel Report on *Japan - Taxes on Alcoholic Beverages*, adopted 1 November 1996, WT/DS8, 10 and 11/R, para. 4.40. Appellate Body Report on *Japan - Taxes on Alcoholic Beverages*, adopted 1 November 1996, WT/DS8, 10 and 11/AB/R, p. 21.

[901]*EEC - Oilseeds*, BISD 37S/86, 117-118, para. 114.

[902]Ibid.

(c) Causal connection

6.436 The **United States** recalls that recent Japanese Government studies document that large stores are more likely to carry imports than small stores.[903] The reasons for this greater "import friendliness" of large stores include their greater shelf space which allows them to offer a diversity of brands, and their economies of scale that make direct-to-retail sales efficient for foreign suppliers. The United States points out that numerous other studies by Japanese Government, industry, and academic experts also found the greater likelihood of large stores to carry imports.[904] The United States also claims to have submitted a methodologically rigorous survey demonstrating that large stores are more likely to carry foreign film. Specifically, according to that survey, foreign film was available in 40 percent of stores under 500 square meters, 49 percent of stores between 500 and 2,999 square meters, and 63 percent of stores 3,000 square meters and greater. Moreover, the United States' analysis of the retail film survey conducted for this case and submitted by the Japanese Government reveals that stores subject to the Large Stores Law were significantly more likely to carry foreign film than small stores (those under the Large Stores Law floorspace minimums).[905]

6.437 In **Japan**'s view, the United States has not proved that restrictions on large stores impede imports of film or paper. As to the US argument that large stores are especially accessible to imports because of economies of scale in their purchasing activities, Japan responds that the presence of economies of scale is not dependent upon retail floor space.

6.438 With regard to the US evidence showing a correlation between store size and propensity to sell imported film, Japan responds that this evidence fails to take into account the type of retail outlet and the relative film sales volume of the outlets surveyed. In Japan's view, proper analysis shows that the availability of imported film has no correlation with the store size, in particular because of the small size of film. Japan presented the results of a survey of approximately 2,000 stores, comparing

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[903]The United States cites the following Japanese Government studies in support of these points:

(i) A 1989 study by the Economic Planning Agency found that relaxing the restrictions on large stores would promote competition and "facilitate the promotion of imports;" Economic Planning Agency, Planning Bureau Research related to Impact Prices, 1989, p. 23, 45, US Ex. 89-1.

(ii) A June 1995 study by the JFTC's Government Regulation and Competition Policy Research Council found that Japan's regulation of large stores interfered with the expansion of imports of products; JFTC Concerning the Reevaluation of Government Regulations in the Distribution Sector, June 1995, US Ex. 95-11.

(iii) Another 1995 study by the JFTC found that the restrictions on large stores hindered price competition and imports; JFTC, Research on Domestic and Imported Products Sold at Lower Price, June 1995, pp. 29-30, US Ex. 95-10.

(iv) A December 1995 study by the Small and Medium Enterprise Agency found that stores with higher annual sales were more likely to carry imports. MITI Medium and Small Industry Agency, Medium and Small Retail Data Book: Current Situation and Issue in the Medium and Small Retail Industry, 1 December 1995, pp. 96, 98, US Ex. 95-19.

Japan responds that none of these studies makes any attempt to supply any statistical data in support of the contention that large stores generally are more likely to carry imported products than smaller ones.

[904]Examples cited by the United States include:

(i) In 1987, Japan's leading business association that includes all major manufacturing exporters, the Federation of Economic Organizations, issued a proposal for stimulating imports of manufactured goods into Japan. The proposal noted that "large-scale retailers are actively selling imported products and have plans to continue doing so, but on the other hand a variety of regulations make it difficult to carry out these plans [including the Large Stores Law]". Proposal On The Stimulation of Imports of Manufactured Goods Based On The Results of Case Studies of Individual Products, Japan Federation of Economic Organizations, 22 September 1987, US Ex. 60.

(ii) In 1982, a JFTC study concluded, "the relatively small size of the stores and limited retail floor space … imposes a limit on how many different products they can carry". The study also found, "most department stores and major supermarkets have taken a positive stance toward introducing foreign brand name products". Kyoso Mondai Kenkyujo, Kosei Torihiki Joho, 17 May 1982, US Ex. 43.

[905]See sub-section V.B.2.(a) on "Import-friendliness of large stores" above, in particular para. 5.243.

the relative foreign film brand availability in stores covered and not covered by the Large Stores Law: The availability was essentially identical.[906]

6.439 The **United States** contends that the fact that film is a small product is irrelevant to the correlation between store size and imports. While a single roll of film might not take up much room, carrying several different types and speeds of film from several different manufacturers takes up considerable retail space. If a retailer carries a full line of one brand of film, to create competing displays for Kodak, Fuji, Konica, and Agfa would mean quadrupling the floor space dedicated to film. Accordingly, it is not the size of the product that matters, but the size of the display for the product in all its variations and all the competing brands that is the issue.[907] In most stores shelf space is a precious commodity, and each retailer must make choices about how many different types of products and different brands to carry. The United States concludes that limitations on floor space by the operation of government regulation very much can affect the choices that retailers make about the number of brands and diversity of products they will carry.[908]

6.440 **Japan** responds that retailers do not necessarily display a full-line of one brand. They may sell a partial lines of several different brands based upon their own business decisions as to which products and which brands will maximize profit. Thus, even small convenience stores may carry multiple brands, while large stores do not necessarily have a large area devoted to film.

6.441 With respect to Japan's contention that instead of the correlation between a store's size and its likelihood of carrying foreign film, a better correlation is between a store's volume of film sales and its likelihood of carrying foreign film, the **United States** responds that these two findings are not mutually exclusive if a store's volume of film sales correlates with its size. In the US view, a large store is also more likely to have a higher volume of film sales, and in both cases it is more likely to carry foreign film. The United States argues that in general larger stores have higher volume sales[909] and that Japan has not submitted credible data to show that this logical correlation does not apply in

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[906]Survey conducted by Nippon Research Centre Ltd. and Commissioned by Fujifilm during the Section 301 proceedings. Fujifilm's Rebuttal Regarding the Alleged "Distribution Bottleneck", 21 December 1995, Japan Ex. A-16.

[907]A full display of Kodak film would include, at a minimum, 100, 200, 400, and 1000 ASA colour film, in rolls of 12, 24, and 36 exposures, for slides and for prints, as well as black and white film and "multipacks" combining rolls of various speeds, and single-use cameras. In the colour film product line alone, Kodak offers the following items: Super Gold in 100, 200, 400 and 1600 - in single rolls (12, 24, 35, and 36 exposures), and in 2, 3, 4, or 5 roll packs; Royal Gold in 25, 100, and 400 - in single rolls (24 and 36 exposures), and 2, 3, or 5 roll packs; Ectochrome Dyna in 50, 100, 200 and 400 - in single rolls (24 and 36 exposures), and 5 and 20 packs; Chrome in 25, 64, and 200 in single rolls (24 and 36 exposures), and 3 and 10 packs; single use cameras in five different varieties including a new APS version.

[908]In a letter of December 1996 to MITI, Japan's largest photospecialty retailer, Yodobashi, makes clear that a downward revision of its floorspace plans for a new store affected the retailer's ability to market foreign film as it had planned. The letter protested the decision in the large-store review process to reduce the store's floorspace from the proposed 8,050 square meters to smaller than 6,500 square meters: "… if we reduce the store's floorspace, a situation can be anticipated in which our company's store-opening plan itself might become impossible to implement. Moreover, even if we tried to maintain the previously planned efficiency using the reduced floor area by changing the content of our store plan, we would have no other choice than to drastically change the plan so that, for example, the sales display of imported film … would have to be reduced". Letter Form Akikazu Fujizawa, President, Yodobashi Camera K.K. to Director General Tohoku Region Trade and Industry Bureau, MITI, Members of the Tohoku Committee and Large Retail Store Deliberation Council, RE: Report from Yodobashi Camera to MITI Concerning the Opening of Their New Retail Store in Sendai, 6 December 1996. US Ex. 102.

In response, **Japan** points out that in the letter, the President notes that shelf-space for imported film will have to be cut back, but also explains the real reason for this policy is the poor sales record of imported film, not its foreign origin. Moreover, according to Japan, the store in question, Yodobashi Camera, is actually selling imported film today.

[909]Data published by MITI show a direct correlation between store size and annual sales in Japan: e.g., less than 1 percent of the smallest stores (less than 33 square meters) have annual sales greater than 300 million yen, while percent of the largest store category (more than 218 square meters) have sales in excess of 300 million yen. MITI, Current Status and Challenges Facing Small and Medium-Sized Retailers, 1 December, 1995, p. 1, US Ex. 92.

the case of photographic film.[910] In fact, an analysis of the Japanese survey data submitted at the US request[911] reveals that stores subject to the Large Stores Law were significantly more likely to carry foreign film than small stores (those under the Large Stores Law floorspace minimums), and that the stores subject to the law also sold higher volumes of film.[912] The United States concludes that Japan has refuted neither the general studies nor the film-specific study showing a clear correlation between store size and likelihood to deal in imports. The United States maintains that the suppression of large stores in Japan is a suppression of sales opportunities for imports.[913]

6.442 **Japan** further argues that both of the surveys agree that a store selling a high volume of film, for example photospecialty stores and supermarket stores, are likely to carry multiple brands to meet their consumers' demand, while others like kiosks tend not to do so, as described in Section V.B.2(c) above. Japan further points out that it is clear that what a market survey shows is not the competitive relationship between products, but the results of market competition, which is generated from the complex interaction of various factors, among which the competitive relationship is no more than one factor. Thus, competitive relationship cannot be deduced from market survey results.

6.443 For Japan, the United States claims regarding the Large Stores Law do not have any logical relevance to photographic paper, since that is a producer, not a consumer product. First, photographic paper is not sold at retail, it is rather sold to photofinishing laboratories which are virtually never covered by the Large Stores Law. Second, the US argument about discouraging multiple brands is irrelevant in the context of photographic paper because no purchasers use multiple brands of paper at the same time. Thus, in Japan's view, the Large Stores Law does not affect the propensity of a photofinisher to choose domestic or foreign brands of photographic paper.

(d) Change in policies or continued restrictions of large stores

6.444 The **United States** argues that the concern that large stores would undermine the manufacturer-dominated distribution system is recurrent in surveys by Japanese Government: It is reflected in the 1969 survey of transaction terms in the photographic film sector;[914] in 1986, the Economic Planning Agency made the same connection;[915] in 1989, a Japanese survey drew the same connection between

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[910]The United States criticizes that Japan presents an unusable diagram, with an unreadable scale, based on indefensible methodology, from which no conclusion can be drawn.

[911]First Panel Meeting, Japan's Response to US Question 2.

[912]In the US view, as with any scientific study, credibility depends on submitting the entirety of one's data and analysis for scrutiny and verification by other experts. The United States in this case provided the entirety of its data to Japan, including each individual questionnaire response.

[913]The United States has performed another run of its data using store type as a proxy for sales volume. Specifically, the United States sorted its data on the assumption that: (I) kiosks, small convenience stores, pharmacies, and cleaners were likely to deal in small volumes of film; (ii) large convenience stores, convenience stores at tourist sites, and grocery stores were likely to deal in intermediate volumes of film; and (iii) photospecialty stores, supermarkets, and discount stores were likely to deal in the largest volumes of film. According to the United States, this data shows that the correlation between store size and imports holds even when controlling for sales volume, (i.e., these store types).

In response, referring to the category (iii) above, **Japan** argues that the two surveys themselves indicate no meaningful difference in the imported film availability at stores included in this category, regardless of whether the store size is above or below 500 square meters. The remaining stores - not major distribution channels of film - consist of convenience stores and kiosks for the most part, and show the lower availability of imported film. Stores selling a high volume of film, for example, photospecialty stores and supermarket stores, are likely to carry multiple brands to best meet consumers' demand, while other stores like kiosks tend not to do so.

[914]Institute 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.

[915]"What are the factors behind such a large number of micro-sized retail stores in Japan? The following factors may be cited … (3) keiretsunization of distribution by oligopolistic manufacturers". Distribution and Business Practices of Imports, Edited by the Price Policy Department, Price Bureau, Economic Planning Agency, 28 March 1986, US Ex. 54. In addition, the United States presents an economic analysis from Japanese antitrust scholars that confirm the connection between restrictions on large stores and Japan's oligopolistic distribution system. These scholars explain that the Large Stores Law disrupted

the growth of large stores and a challenge to vertically integrated distribution.[916] In the US view, this demonstrates that concern about the market power of large stores and chain stores persists in all segments of the market.[917]

6.445 **Japan** responds that it was never the intention of the Japanese Government to protect the alleged oligopolistic, manufacturer dominated distribution structure in the Japanese film market. On its own terms, the Large Stores Law regulates large stores without regard to what relationship they and nearby small and medium-sized retailers have with any manufacturer or distributor. Japan points out that the Large Stores Law was designed to preserve a diversity of retailing outlets, a policy pursued by many national and local governments around the world. Accordingly, the law does not regulate convenience store chains, which are outside the alleged exclusive distribution network of domestic manufacturers, and which are competing with small retailers that may have a particular affiliation with domestic manufacturers. Japan further submits that the materials cited by the United States do not support the US claims; for example, the 1969 report simply notes the need for existing stores to streamline commercial practices to improve their efficiency.

6.446 Japan points out that, while the law and its 1978 amendments were passed after the 1967 tariff concessions, these changes represented an "outgrowth" of pre-existing policy, namely the Department Store Law of 1956. Japan emphasizes that the Large Stores Law is more liberal than the Department Store Law was in 1967, in particular, in light of its more liberal notification system and fewer regulations on store holidays and closing time.

6.447 Further, Japan asserts that the Large Stores Law today is more liberal than its operation in 1994. Thus, even if it were accepted that restrictions on large scale retail stores are unfavourable to imported products, the law is now more favourable to imports. Three sets of deregulation of the Large Stores Law during the early 1990s were completed by 1994, and there have been no significant changes since then. In particular, Japan explains why the law is currently more liberal than in 1979: The law does currently not make any adjustment for a closing time that is no later than 8:00 p.m., or for store holidays no fewer than 24 days; whereas in 1979, the corresponding figures were 6:00 p.m. and 48 days. Since 1994, the law has also been liberalized largely to exclude stores in the 500 square meters to 1,000 square meters range from the normal adjustment procedures under the law.[918] Japan further emphasizes that efforts by the Japanese Government to ensure that local governments more faithfully adhere to the national standards for administering this law make it more liberal.

6.448 Japan submits that in the alternative, if the changes in measures which occurred after the relevant tariff concessions are not currently in effect, but were nonetheless deemed relevant to a determination regarding the upsetting of the competitive position of imports, the 1978 amendments extending the reach of the law from stores with 1,500 square meters to stores with as few as 500 square meters could

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"pursuit of economies of scale" in the distribution sector, which contributed to inefficiency and a lack of competition in the distribution sector. This in turn "had provided a comfortable profit source for Japanese exporting firms" and had worked "to foreclose the access of foreign products into the Japanese market". The scholars added, "[a] distributor's dependence on a particular manufacturer would make distribution channels exclusive and raise entry barriers significantly". The Antimonopoly Laws and Policies of Japan, J. Iyori and A. Uesugi, Federal Legal Publications, Inc., 1994, p. 293, US Ex 94-1.

[916]In June 1989, the Economic Planning Agency (EPA) concluded that deregulation of restrictions on stores would: "not only serves to encourage horizontal competition among different types of businesses, but also encourages vertical competition through the exercise of buying power, thereby producing the results and effects of a relative lowering of commodity price levels and broadening the line of product offered through the promotion of develop-and-import schemes". EPA, Economic Theory of Deregulation, 10 June 1989, US Ex. 64.

[917]As a general matter, in the US view, there can be no doubt that large stores tend to have more market power than small stores. The United States submits that surveys and studies performed by and for the Japanese Government repeatedly make the connection between controlling large stores and protecting the oligopolistic distribution system.

[918]Japan argues that stores in this retail space range are in principle exempt from the Large Stores Law process and that only 2.9 percent of stores in this retail space range had to go through the law's full process.

be seen as a regulatory tightening. However, Japan argues that these changes were already part of the operating environment of the law by 1979. With respect to the US complaints about alleged regulatory tightening in the early 1980s, Japan responds that these allegations are legally irrelevant since those measures have since been repealed. The relevant comparison is between current competitive conditions and the competitive conditions, at the time of the relevant tariff concession, not competitive conditions that may have occurred along the way.

6.449 The **United States** responds that stores with a floor space of less than 500 square meters, e.g., convenience stores, are frequently subject to review and adjustment under the measures applied by local governments.[919] Japanese Government studies have found that these local regulations continue to be widespread and that they impose a significant burden on the opening of stores less than 500 square meters. Just as under the Large Stores Law, the local measures frequently require a builder or retailer to provide advance notice of its plans to establish or expand a new store, and to undertake adjustments with local competitors. In support of this position, the United States provides an agreement between a convenience store retailer and a local shopping center association in which the association made several demands of the retailer. In the end, the retailer felt compelled to enter into an agreement with the shopping center, which among other things limited the retailer's floorspace, mandated certain holidays and closing times, restricted the retailer's ability to "sell competing products at a significant discounted price," and required the retailer to advertise on behalf of its competitors.[920]

6.450 **Japan** responds, however, that in January 1992 the Government expressly abolished administrative guidance regarding prior explanation, and made this fact well known to all the prefectural and municipal governments, as well as all the MITI branches by Circulars. Since then, the government has made its best efforts to correct any local regulations which require or recommend prior explanations or prior adjustments, and consequently, no such local regulations exist.

6.451 Further, Japan points out that at the stage of the Council deliberation, it is neither MITI nor prefectural governments, but the Council itself that selects parties to present their views. The relevant circular requires that those parties include consumers and neutral persons of learning and experience, and that the choice ensure equitable representation. Further, according to Japan, the United States relies on several erroneous translations of the cited reports by the Japanese Government in support of its contention that the Council is strongly influenced by local retailers.

6.452 The **United States** rejects Japan's arguments that the Large Stores Law and related measures do not currently suppress the growth of large stores, and that the law has been liberalized significantly in recent years. In the US view, Japan does not appear to refute the fact that the law aggressively checked the growth of large stores in past years, but rather asserts that it liberalized the law in the early 1990s.

6.453 The United States maintains that the operation and application of the Large Stores Law does currently suppress the growth of large stores as well as that Japan has imposed restrictions on large stores for decades in the past. This suppression of large stores has supported the oligopolistic distribution system, and has limited an alternative channel for foreign products to reach the Japanese market. Without Japan's strong measures against large stores, in the US view, large stores might have brought sufficient bargaining power and competition into the Japanese distribution system to erode the exclusive vertical control over distribution exercised by Japanese manufacturers.

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[919]According to the United States, Japanese Government studies have found that local regulations continue to be widespread and impose a significant burden on the opening of stores less than 500 square meters.

[920]Arrangement Between A New Retail Store and the Local Shopping Center Association, 1996, US Ex. 93.

(e) Conclusions

6.454 The United States summarizes that it has documented conceptually, empirically, and anecdotally how the formal and informal adjustment processes continue to impose substantial burdens on the establishment and operation of large stores in Japan.

6.455 *Conceptually*, the United States explains that:

- Floor space reductions reduce store revenue, and therefore may force a retailer to operate at a size less than optimal for its profitability.[921]

6.456 *Empirically*, the United States argues that it has demonstrated that the formal and informal adjustment procedures continue to be applied aggressively:

(i) According to the United States, data submitted by Japan indicates that in 1992 to 1995, floorspace reductions were imposed in 22 to 27 percent of the cases. For these cases, the average amount of floor space reduction was 24 percent. Thus, even today, after the supposed liberalization, one-quarter of large stores face reductions of one-quarter of their proposed floor space. For the United States, this is a significant burden on large stores. Moreover, information submitted by Japan indicated that in 4 percent of store notifications, the formal adjustments imposed are so burdensome as to cause the store to cancel its plans to open.

(ii) Information submitted by Japan also documents that approximately one-quarter of large stores are forced to add holidays and shorten hours of operation.

(iii) The United States point out that these numbers greatly understate the extent of reductions, since, as the Japanese Government itself documents, in many cases stores undertake adjustments as a result of the informal adjustment process that takes place before a store submits formal notification. According to the United States, the Japanese Government documents that many stores are likely to prefer to make their adjustments through the informal process, since if they fail to reach consensus with their competitors, they may be subjected to an even greater adjustment in the formal process.

6.457 *Anecdotally*, the United States reported on several cases in which stores faced significant adjustments and restraints on their operations as a result of either the formal or informal adjustment process.[922]

6.458 **Japan** contends that the United States has failed to demonstrate how the Large Stores Law currently nullifies or impairs tariff concessions for consumer photographic film.

a. *Conceptually*, Japan points out that the United States has failed to explain why restrictions on large stores alter the competitive conditions relating to the specific product, i.e., consumer film, so as to disadvantage imports. Japan emphasizes that the law does not in any way regulate which products are carried by large stores, much less the origin of these products; similarly, the law does not regulate large stores based on which products they or the small retailers in their vicinity carry, much less the origin of the products they carry. Japan argues that retailers

[921]The United States submits recent evidence from a retailer describing the revenue loss for different levels of floor space reduction, as well as an industry journal report attributing declines in the profitability of Japan's largest retailer to reductions in its floor space and operations arising from the Large Stores Law.

[922]See, sub-section V.B.6.(a) on "Adjustments under formal procedures" above, in particular para. 5.330.

choose products to maximize profits, and that there is no reason to believe that restrictions on the size of retail space changes the relative profitability of film products to the advantage of domestic brands of film. Moreover, Japan explains that there is no reason to believe that small and large stores approach profit maximizing differently.

b. *Empirically*, Japan argues that the United States also has failed to demonstrate any causal connection between restrictions on the operations of large retail stores and the sale of imported consumer photographic film. For Japan, although the competitive relationship between products cannot be deducted from market survey results, the only verifiable survey relied upon by the United States failed to actually take account of either the type of retail outlet or the film sales volume of the outlets surveyed. Further, both of the surveys indicate that stores selling a high volume of film, for example, photospecialty stores, and supermarket stores, are likely to carry multiple brands to meet their consumers demand, while others like kiosks tend not to do so, as described in Section V.B.2(c). Thus, while the United States fails to meet its burden of demonstrating a causal connection, the evidence provided by Japan demonstrates a lack of causal connection.

5. PROMOTION "COUNTERMEASURES"

(a) General overview

6.459 According to **Japan**, when the Japanese economy entered the phase of mass production and consumption in the 1950s, premiums sales, including promotional lotteries, became increasingly popular. Prize money and merchandises grew very expensive. The society grew concerned about these promotional prizes which encourage speculative behaviour and could impede consumers' rational selection of goods. Concerned about the lack of adequate means to control misrepresentations, the public called for the introduction of effective control of misleading representation.

6.460 With respect to the *Kennedy Round*, the **United States** submits that the 1967 Cabinet Decision approved the use of countermeasures for "preventing foreign enterprises from disturbing order in our industries".[923] The Japanese Government recognized that, in general, the marketing and promotional abilities of Japanese firms were weaker and their costs were higher than those of foreign enterprises, and thus Japanese firms would be at a disadvantage in relation to foreign firms. To address these problems, the JFTC imposed new restrictions on the use of premiums. The United States claims that the JFTC's actions in this regard upset the conditions of competition between imported and domestic products after the Kennedy Round by severely limiting the inducements enterprises could use to attract wholesalers, retailers, and consumers to their products.

6.461 Following the *Tokyo Round*, according to the United States, the Japanese Government applied its promotion countermeasures against film and paper in distinctly new ways. For the first time, Japan unleashed its cartel-like private sector enforcement councils to regulate commercial matters specifically related to film and paper. The codes established by these councils constrain the use of two forms of economic inducements: (1) dispatched employees; and (2) economic contributions to retail promotions. The codes also restrict a variety of different representations made in advertisements for photographic materials, especially where discount or price-oriented promotions are involved. The United States alleges that the series of promotion countermeasures serves to reinforce the framework of restrictions the Japanese Government established after the Kennedy Round. These new and strengthened measures operated to upset the competitive relationship between imports and domestic products in Japan's photographic materials market by constraining the ability of imports to assail the dominance of domestic

[923]1967 Cabinet Decision p. 3, US Ex. 67-6. In the film sector, the domestic industry was "afraid that Kodak would use its capital strength to control the market with huge incentives like low prices, or attach some kind of gift to the film". New York Times, 5 July 1995, US Ex. 95-14.

market leaders through aggressive marketing techniques and utilization of alternative distribution channels.

6.462 The United States submits that during the negotiations of the *Uruguay Round*, the United States and Japan's other trading partners who produced photographic film and paper knew that the Japanese market was difficult to penetrate, but the way in which the promotion countermeasures, the distribution countermeasures, and the Large Stores Law, worked in concert to systematically offset tariff concessions was not known. The United States claims that the ongoing application of this web of liberalization countermeasures has continued to operate to nullify or impair benefits accruing to the United States not only from the Uruguay Round, but also the Tokyo and Kennedy rounds, due to, inter alia, the inability to price and promote products effectively and competitively as a result of restrictions under the Premiums Law and Antimonopoly Law.

(b) JFTC Notifications under the Premiums Law

6.463 The United States points out that, in May 1967, the JFTC issued Notification 17, which banned most premium offers between businesses. The United States has explained that this restriction had a particularly inhibiting effect on establishing or improving relations between photographic material manufacturers and Japanese distributors. The United States further submits that, in July 1971, the JFTC issued Notification 34, ruling that prizes offered through advertised lotteries, involving no required purchase of a product, could not exceed 1,000,000 yen. In March 1977, the JFTC issued Notification 5 which imposed limits on the value of a premium and had the effect of severely restricting the offering of premiums on photographic film and paper to general consumers. Given the relatively low price of these products, the value of any premium falling within the JFTC's restrictions would be negligible. The United States argues that, with Notification 17 and MITI's 1970 Guidelines for Standardized Transaction Terms, the JFTC's new measures on premiums upset the competitive relationship between imported photographic film and paper and the domestic products by severely limiting the ability of challenging brands, e.g. foreign manufacturers, to attract Japanese consumers through marketing and promotions. Following the Kennedy Round, imported photographic film and paper had a very limited market share - the legacy of years of import restrictions, high tariffs, and foreign investment restrictions. Producers challenging leading brands need to promote their products to attract consumers. For products like film, the promotion must be significant enough to overcome strong consumer brand loyalty because the consequences of product failure are so significant, e.g., poor pictures of an important event. By imposing significant limitations on the premiums that can be offered in open lotteries or in conjunction with sales to general consumers, the JFTC not only severely restricted the extent to which the foreign enterprises could draw attention to their imported products, but also prevented foreign enterprises from exceeding the premiums offered by their Japanese competitors. The United States concludes that in so doing, Japan disrupted the conditions of competition in the Japanese market that otherwise would have prevailed and that would have enabled imports from other countries to take advantage of the tariff concessions.

(i) Competitive position of imports

6.464 The United States alleges that the promotion countermeasures have directly interfered with and upset the competitive relationship between domestic and imported products in the Japanese market by constraining the ability of the person selling imported products to: (1) attract consumer interest in imported products through discounts, gifts, coupons and other price-cutting methods; and (2) rely on innovative promotional campaigns, particularly ones in which prices or price comparisons are discussed. According to the United States, the Japanese Government perceived that the marketing and promotional abilities of Japanese firms were weaker and their costs were higher, and Japanese firms were less able to compete aggressively on the basis of price with foreign firms and imports. While foreign producers regularly advertise and otherwise promote their products in Japan, they have been substantially chilled from doing the promotions necessary to compete effectively. The seeming neutrality of these measures belies the fact that they decisively tip competitive conditions against imports,

which more than domestic products need to rely upon premiums and other promotions if they are to attract the attention of distributors and consumers.

6.465 **Japan** contends that the Premiums Law does not establish conditions of competition that are unfavourable for imported film or paper. The express text of the Premiums Law makes no distinction between imported or domestic products. In general, the regulation of premiums and representations under the Premiums Law, which aims at protecting consumers' interests and promoting competition, applies equally to imported and domestic products, and thus does not disadvantage imports. Moreover, there is nothing about restrictions on excessive premiums or misleading representations that is inherently unfavourable to imports, nor is there anything intrinsic in the nature of imports that makes them particularly reliant on misleading representations or the excessive premiums regulated by this law.[924] The Premiums Law is trade-neutral in the sense that its impact on the market access will be felt equally by domestic and foreign products. In response to the "chilling effect" argument, Japan argues that the United States should show how the combination of the regulation, a code, and the Promotion Council has operated systematically against imported products. Japan concludes that the present regulations are not excessively restrictive or disadvantageous for imported products with a lower market share, than for domestic products.

6.466 The **United States** concedes that the promotion measures are facially neutral. However, in the US view, Japan ignores the disparate impact its measures have had on imported photographic materials and understates the significance of the promotional activities it has banned. Although the measures are facially neutral, they help preserve the dominant position of Japanese film and paper manufacturers by shielding them from significant forms of promotion competition. Marketing is especially important to foreign producers challenging the domestic market leaders because they have been excluded from the primary wholesalers, they have limited distribution alternatives in terms of large retail stores, and their opportunities to compete through price discounts are minimal.

6.467 **Japan** argues that other economically advanced countries have counterparts of these regulations, and the Japanese regulations are in no way more restrictive than these counterparts. Moreover, even if regulations are eased, dominant brands are likely to counter such attempts with promotional activities of their own. Consequently, in this particular market at least, relaxation of the regulations would not necessarily operate to the advantage of the challenging brands.

6.468 The **United States** argues that Japan's promotion countermeasures must be viewed in light of the peculiarities of Japan's photographic materials market. These restrictions disadvantage imported film and paper because they serve to reinforce the significant advantages of the domestic manufacturers that have dominated Japan's photographic materials market since 1945. These domestic manufacturers have consistently controlled 80 to 90 percent of Japan's market. They have exclusive access to Japan's leading photospecialty wholesalers and their products are allocated far greater shelf space in retail stores which most often do not carry any foreign film at all. In the US view, given the oligopolistic nature of the market and the bottle-necked distribution system, foreign photographic material manufacturers are acutely dependent upon marketing to generate demand for their products among wholesalers, retailers and consumers. In particular, impediments placed in the way of offering premiums or advertising about a price discount act as a barrier against greater market access for imports.

6.469 **Japan** submits that the Premiums Law, JFTC Notifications and other JFTC regulations govern activities of business entities as they focus on competitive behaviour of these entities. The provisions are unrelated to the origin of the products, and do not inherently afford more favourable treatment to domestic products. Thus, there is no element of discrimination which would nullify or impair benefits accruing to the United States under Japan's tariff concessions. According to Japan, the United States

[924] *United States - Automobiles*, DS31/R, para. 5.14 (unadopted).

emphasizes the disadvantage felt by a challenging brand against a dominant brand, and not that between imported products and domestic products. Japan recalls that Fuji is not the only domestic brand, there are domestic challenging brands including Konica in the Japanese market.

(ii) Objectives underlying the promotion "countermeasures"

6.470 Japan notes that the Premiums Law is a sub-set of competition law whose objective is the prevention of excessive premiums and misleading representations for purposes of consumer protection. Article 1 of the Premiums Law defines its objective as "to secure fair competition, and thereby to protect the interest of consumers in general by establishing provisions to prevent inducement of customers by means of unjustifiable premiums or misleading representations". Reference to the twin objectives of fair competition and consumer protection is also recorded in various parts of the Diet minutes.[925]

6.471 The **United States** contends that Japan's restrictions not only were intended to protect consumers, but they also were designed to protect domestic production. For the United States, this purpose is evident in a variety of measures, such as Japan's 30-year restriction on the use of premiums between businesses, a measure which had less to do with consumer protection than dampening competition from foreign competitors.[926] In the US view, Japan has recognized that its dominant domestic manufacturers are vulnerable to promotion competition from foreign producers.[927] Japan believed that foreign competitors have advantages in terms of the expertise and capital they could rely upon in promoting their products in Japan.[928] According to the United States, the Japanese Government determined that, if unchecked, foreign competitors, especially Kodak, could increase their presence in Japan's market through innovative promotions,[929] and Japan, therefore, instituted countermeasures to "create a foundation" on which Japanese companies could "compete on equal terms" with their foreign rivals.[930] In enacting the Premiums Law, Japanese officials hoped that the facially neutral measure would prevent circumstances in which "foreign trading companies … may come into Japan and enjoy advantageous positions through excessive advertisements or by inviting buyers to foreign countries".[931]

6.472 In **Japan**'s view, the US claims rest on a conspiracy hypothesis. Japan emphasizes that the truth is that the JFTC has long been an active advocate of a more open Japanese economy.[932] For

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[925]Minutes of the House of Councillors, Committee on Commerce and Industry, 13 April 1962, Japan Ex. D-19, US Ex. 62-2.

[926]The JFTC explained when it promulgated Notification 17: "The primary objective of [Notification 17] is (a) rationalization of the distribution stage …; and (b) eliminat[ion] of the stronger prey upon the weaker sales competition based on the power of capital … If US capital were to conduct [premium offers] directed at the Japanese distribution sector, this would be no match for [Japan], so the restrictions should be applied as a breakwater before liberalization". Severe Restrictions Placed on Businesses for Premium Offers: Shatokuren Hears JFTC Explanations at Jyosui Kaikan on the 12th, Nihon Shashin Kogyo Tsushin, 20 June 1967, US Ex. 67-8.

[927]"Along with the liberalization of capital and trade, the major issues facing this industry today include the US landing in Japan and market expansion … The struggle to capture market share will depend substantially on promotional activities based on financial strength". MITI, Manual for the Systemization of Camera and Film Distribution, March 1975, p. 58, US Ex. 75-5.

[928]See, e.g., Preparing for Capital Liberalization: Rationalization of Trade Practices is Urgent Task; Foreign Capital Attacks on Two Fronts - Production and Sales, Nihon Shashin Kogyo Tsushin, 10 June 1967, p. 10, Draft a Standard Contract for Film With Criteria for Standardization of Transactions Terms, Zenren Tsuho, August 1971, US Ex. 71-11.

[929]New York Times, 5 July 1995, US Ex. 95-14.

[930]1967 Cabinet Decision p. 4, US Ex. 67-6.

[931]Diet Record of the 40th Session of the Lower House Committee on Commerce and Industry, No. 31, 18 April 1962, US Ex. 62-4.

[932]The JFTC Chairman stated in 1967: "Although it is the JFTC's responsibility to vigorously enforce the Antimonopoly Law, should foreign capital commit acts of [unfair trade practices], we shall not discriminate the foreign capital by imposing more burdensome regulations compared to Japanese entities. We recognize the importance of industrial reorganization and of strengthening the international competitive position of the Japanese business in pursuance of the policy towards capital liberalization ."..

Japan, the JFTC's history is pictured by the United States as that of a collaborator in counteracting the effects of trade liberalization.

6.473 The **United States** responds that Japan has offered no explanation as to how consumers benefitted from the JFTC's simultaneous certification of a camera cartel, the issuance of a notification almost completely banning the use of premiums by any business that manufactures or sells cameras, and the approval of codes restricting the use of premiums among camera manufacturers and wholesalers. The United States emphasizes that the JFTC has acknowledged that a major factor in taking these protective measures was stiff competition from Kodak, especially the development of its innovative, easy installation film.[933]

6.474 With respect to "fair competition codes" (discussed in Section (c) below), the United States argues that the Japanese Government established its private-sector-enforced code system, at least in part, to counteract the perceived superior marketing abilities and promotion budgets of foreign firms. As a leading Japanese antitrust scholar has explained: "Fair competition codes can also be effective in controlling foreign firms if they disturb the market".[934]

6.475 According to the United States, even though the countermeasures were neutral on their face, the impact (and intended impact) on competition decidedly was not. In fact, the measures substantially disrupted the competitive relationship between imports and domestic products by placing severe constraints on a key comparative advantage of the imports, i.e., their ability to promote and market products effectively and creatively. In the view of the United States, these restrictions take on even greater significance given the closed distribution system, oligopolistic nature of the market, and the existence of other constraints such as the Large Stores Law.

6.476 **Japan** notes that the "intent" of the government is irrelevant for purposes of a non-violation claim, given that the panel on *Japan - Taxes on Alcoholic Beverages*[935] found that the interpretation of domestic law should be based primarily on the text of the statute, rather than the legislative history. Japan responds to US arguments about "intent" to protect the domestic industry by introducing regulations more favourable to domestic products as follows:

6.477 Japan submits that in statements before the Diet Committee at the time of introduction of the Premiums Law, the reference to foreign capital reflects an origin-neutral response to anticipated changes in competitive conditions on the eve of liberalization of foreign capital, a phenomenon unprecedented for the Japanese economy. In Japan's view, no intent of discrimination can be found. The introduction of the Premiums Law was well before the capital liberalization of the late 1960s, and was a result of circumstances unrelated to foreign capital.

6.478 Japan emphasizes that the Cabinet Decision of June 1967 did not contain any measure related to the Premiums Law. Nor did the JFTC take any measure. The reports of the Foreign Capital Council's Expert Committee also reflect an origin-neutral response to anticipated changes in competitive conditions on the eve of capital liberalization.

6.479 Japan admits that the JFTC officials in charge of Notification 17 appear to have been conscious of foreign capital. For Japan, however, it is a legitimate, universal phenomenon for people in the policy-making process to assess the impact of a major policy change on the market. Japan does not find intent to discriminate against imported products in favour of domestic products. On the contrary,

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[933]Otsuka Noritami, JFTC Trade Practices Division, Recent Activities Concerning the Premiums Law, Kosei Torihiki, November 1965, p. 3, US Ex. 65-5.

[934]Matsushita Mitsuo, Antimonopoly Law and International Transactions, 25 May 1970, p. 817, US Ex. 70-2.

[935]*Japan - Alcoholic Beverages*, WT/DS8/R, para. 87.

two Chairman of the JFTC made very clear in 1967 that the Commission should not discriminate against foreign capital.

6.480 Japan emphasizes that the ultimate litmus test of intent should be whether or not there is recognizable "intent" or "objective" built in the structure of the system in dispute, rather than individual statements. The fundamentally origin-neutral regulation of the Premiums Law contains no such built in mechanism based on an "intent" or "objective" of discrimination.

(iii) Causal connection

6.481 Japan argues that there is no constraint suffered by foreign film producers in promoting their products. They can compete on price and quality, and are free to spend as much as they want for advertising. According to Japan, Kodak, the leading foreign brand, is often sold at retail at substantial discounts off manufacturer's suggested retail price.[936] Although in general Kodak chooses not to advertise as heavily as its domestic competitors, it does engage in focused campaigns of targeted heavy advertising, with predictable results.[937] In Japan's view, these facts are inconsistent with the US claims that foreign producers are unable to promote their products effectively due to Premiums Law restrictions.

6.482 The **United States** contends that the ability of foreign manufacturers to use price discounts to expand their presence in Japan has been rather limited. Kodak has reduced its prices by 56 percent since 1986, substantially undercutting its Japanese competitors, yet Kodak's dramatic price discounts have had virtually no effect on the market. Similarly, Agfa's aggressive efforts to use discount channels to market its products have yielded only marginal results. Price reductions by foreign photographic material producers, even to levels well below those of domestic competitors, often are not passed on to consumers at the retail level.[938] This lack of price competition in the photographic materials sector is reflected by the fact that Japan's consumer price index for film has shown almost no movement between the third quarter of 1989 and the third quarter of 1996, a period of seven years.[939] Little price differential exists among Fuji, Konica and Kodak at either the retail level[940] or with respect to wholesaler prices to retail outlets.[941] The same lack of price differentiation is observable with respect to various film speeds, types of outlets and individual cities. The United States concludes that limited price competition, coupled with foreclosed distribution channels, renders promotions especially significant to foreign photographic material producers.

6.483 **Japan** points out that American business has been able to compete freely, subject to no restriction whatsoever under the Premium's law, in pricing and quality, the two most important aspects of market competition. There is a wide range of promotional initiatives; the JFTC regulates nothing other than

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[936]Japan notes that among other promotional strategies, Kodak sells film in multipacks at low per-roll prices, cross-promotes with other products, and advertises extensively. Fujifilm's Rebuttal Regarding Vertical and Horizontal Price Fixing, 28 March 1996, pp. 22-23.

[937]Japan notes that Kodak's heavy advertising and promotion in Nagano site of the 1998 Winter Olympics (of which Kodak is a corporate sponsor), has led to a doubling of its market share in the area.

[938]According to the United States, Japan's own exhibits reflect the connection between price stabilization and the promotion countermeasures. A Policy Outline on Commercial Transactions with Customers by the Federation of Primary Wholesalers, stated:

"The notices on the "Fair Competition Code on the Restrictions on Supplying Premiums in the Camera Wholesale Industry" and the Japanese Fair Trade Commission's "Restrictions on the Matters Related to Supplying Premiums", *have both been playing an important role as a part of market price stabilization*. Primary wholesalers will ensure nothing regrettable occurs by giving full consideration to these issues when sponsoring events". Japan Ex. B-31. (Emphasis added.)

[939]Photo Market, 1996, p. 31, US Ex. 101. The United States further submits that in 67 percent of the 99 medium-size cities and small towns surveyed by the Japanese Government in its annual Retail Price Survey, the retail price of film did not go up or down by even one yen for a two-year period between 1992 and 1994. Statistics Bureau, Management and Coordination Agency, Japan's Annual Report on the Retail Price Survey, 1992, pp. 523, 610, 631, US Ex. 74.

[940]Management Analysis of Photo Stores, Camera Times, 1979-1996, US Ex. 40.

[941]Construction Research Institute, Information on Prices, Monthly Edition, December 1972 - September 1996, US Ex. 22.

distortive practices, namely, (i) excessive premiums, i.e., excessive free gifts, and excessive prizes offered through lotteries or competition, and (ii) misleading representations. However, the Antimonopoly Law and the Premiums Law, or their implementation, do not restrict low price offers of photographic film and paper, or the amount of public relations expenditures. Nor are lawful premiums or non-misleading representations restricted.

6.484 The **United States** contends that Designation 6 under JFTC Notification 15 of 1982 prohibits "unjust low price sales", including "unjustly supplying a commodity or service at a low price, thereby tending to cause difficulties to the business activities of other entrepreneurs".[942]

6.485 In addition, the United States provided a number of specific examples in which application of the Premiums Law and the Antimonopoly Law, and the activities of fair trade councils constituted by the JFTC, had the effect of restricting Kodak's discounting and promotional efforts. In the 1983 trial-pack incident, for example, actions by the JFTC and the Promotion Council curtailed Kodak's promotional campaign for a reduced-price package of different rolls of film. The episode involved Kodak's principal new film product of the first half of the 1980's and chilled Kodak's promotional efforts in later years.[943] JFTC Notification 5 of 1977 prevented Kodak from implementing a variety of joint promotions (e.g., offering a free roll of film with a McDonald's Happy Meal and implementing promotions for its Panorama single use camera).[944] The JFTC has taken action to suppress a variety of promotional efforts undertaken by retail outlets in connection with the sale of Kodak products.[945] Kodak has been limited in its ability to dispatch employees to work on the premises of retail stores by periodic directives from the Promotion Council.[946]

6.486 **Japan** submits that regulations on premiums and representations under the Antimonopoly Law and the Premiums Law do not restrict low price offers.

(iv) Change in policies

6.487 Japan submits that in the course of a review of its regulations under the Premiums Law:

(i) the JFTC has streamlined its general rule on excessive premiums last year;
(ii) the restriction on premium offers to businesses has been abolished; and
(iii) the ceiling on prizes has been raised.

Japan notes that each of these measures facilitates new entry into the Japanese market, in a non-discriminatory manner and that these initiatives are undertaken pursuant to the JFTC's commitment under the Structural Impediment Initiative (SII). In Japan's view, these initiatives should be compelling evidence to prove that the JFTC is committed to vigorously pursuing the goal of free and fair competition in the Japanese market.

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[942]Unfair trade practices, JFTC Notification 15, 18 June 1982, US Ex. 82-6. The United States does not consider this designation to be a liberalization countermeasure and seeks no review of this measure by the Panel. The United States only raises it to rebut Japan's contention that Japanese law contains no limitation on low price offers. The United States further notes that the Japanese Government has admitted that it would "monitor" film prices so that Kodak could not dominate the market in Japan as it had elsewhere. Considering Tariff Reductions and International Competitiveness: MITI Examines Print Price and Investigates the Direction of Film Prices (MITI Business Bureau Report), 12 November 1970, reprinted in Zenren Tsuho, December 1970, p. 43, US Ex. 70-8.

[943]Ishikawa Sumio Affidavit p. 2, US Ex. 97-10, Hiromichi Sumi Affidavit, US Ex. 96-10.

[944]William Jack Affidavit, p. 7, US Ex. 97-2.

[945]Affidavit of Isshi Norito, p. 1-3. IS Ex. 97-5, Suzuki Yosuyuki Affidavit, p. 1-2, US Ex. 97-6, William Jack Affidavit, p. 6-9, US Ex. 97-2.

[946]Promotion Council Issue No. 6-3, 17 January 1995; US Ex. 95-7 and National Photographic Industry Fair Trade Promotion Council Issue No. 8-1, 22 July 1996, US Ex. 96-7.

6.488 Japan argues that the enforcement mechanism was certainly augmented by the 1972 amendment, which delegated part of the authority to the prefectural governments. However, in Japan's view, this modification in no way served to alter competitive relationships in favour of domestic goods.

6.489 The **United States** underscores that in the past, the JFTC has interpreted the Premiums Law in a sweeping manner: "Premiums which are the object of notifications refers [sic] to products, cash, marketable securities, entertainment, or other economic benefits which are given in connection with a transaction involving commodity or service".[947] The JFTC has explained that it distinguishes between premiums and price discounts or rebates on a case-by-case basis, examining the facts "in light of normal business practices, taking into account details of the transaction, details of the economic benefit, the method and the conditions of offer, and the customs of that particular industry".[948] In this regard, in the US view, the JFTC has acknowledged that some forms of discounts or rebates may be premiums.[949]

6.490 **Japan** stresses that the Premiums Law does not restrict low price offers or free samples. On the contrary, the Law serves to promote low price offers and other price/quality competition by placing a restriction on excessive premiums. Japan notes that the word "money" as part of premiums was included primarily to cover lottery prizes. Cash lottery prizes, which were widely used in 1962, could become excessive, and are included in premiums subject to restriction.

6.491 The **United States** disagrees with Japan's statement that the use of free samples and low price offers would be "lawful under the Premiums Law at any point in its history". Notification 17 of 1967, restricting premiums between businesses, and Notification 5 of 1977, restricting premiums to general consumers, provide that samples are exempt from coverage only if they are "found reasonable in the light of normal business practices". In addition, certain low price offers may be regulated as an "unjust low price" under Designation 6 of Notification 15 of 1982.

(c) Fair Trade Councils and Fair Competition Codes

6.492 The United States submits that, following the Tokyo Round, in October 1979, the Japanese Cabinet approved the establishment of a Distribution Sector Office (DSO) in the JFTC to "administer duties pertaining to unfair trade practice designations related to distribution".[950] The DSO studied 16 business sectors, and in December 1981 issued findings on cameras and photographic materials advising "camera, photographic materials, colour photo laboratories and related industries" to address "problems" created by manufacturers dispatching employees to large retail stores.[951] Thereafter, the JFTC called upon the photographic industry to develop "self-regulating rules" controlling "the permanent dispatch of sales people".[952]

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

[948]Ibid. p. 16.

[949]Ibid.

[950]Cabinet Order No. 43 of 1979, US Ex. 79-1.

[951]According to the United States, dispatched employees are a unique form of economic inducement between businesses since they reduce costs for wholesalers and retailers and thereby allow for increased sales based upon cost or price reductions passed down the line of distribution.

[952]Kosugi Misao, Trade Practices Department, Distribution Sector Office JFTC, Status of Distribution of Cameras, Kosei Torihiki, No. 377, March 1982, p. 8, US Ex. 82-3.

(i) Promotion Council

6.493 The United States points out that the domestic photographic industry responded in 1982 by forming the Fair Trade Promotion Council (Promotion Council) and by promulgating the "Self-Regulating Measures Regarding Making Business Dealings With Trading Partners Fair". The Council represented all elements of the photographic industry, i.e., manufacturers, wholesalers and retailers, and was formed to act on behalf of the JFTC in enforcing the "Self-Regulating Measures".[953] The Self-Regulating Measures and the Council's articles of association govern the use of dispatched employees and monetary contributions to retail promotional campaigns.[954] The articles of association are noteworthy due to the extraordinary latitude they convey upon the Council, including providing for a firm to seek pre-approval from the council before using dispatched employees.

6.494 **Japan** submits that the Promotion Council was established by the photographic industry as an organization to implement voluntary standards on dispatched employees. The industry was in fact working on such standards even before the JFTC published a report and issued administrative guidance.

6.495 In 1983, the JFTC urged the Promotion Council to expand into dumping and loss-leader advertising.[955] In the view of the **United States**, the Promotion Council recognized that dumping cases are quite complex and often difficult to win, and determined that imposition of regulations controlling advertisement of prices would prove to be a more effective means of restraining competition because the standards are more subjective and do not require the analysis of complex cost and pricing data.[956]

6.496 In May 1984, the Promotion Council issued "Self-Regulating Standards Concerning Display of Processing Fees for Colour Negative Film" defining the information that must appear in connection with a representation of prices for colour film developing and printing, including the printing fee, developing fee, processing time, and paper manufacturer.[957]

6.497 For **Japan**, the intention of "Self-Regulating Standards Concerning Display of Processing Fees for Colour Negative Film" was to give consumers adequate information of both charges. In Japan's view, as such, these self-regulating standards are not related to sales of film products.

6.498 According to the **United States**, by regulating the use of dispatched employees, promotional funds and price-related representations, the Promotion Council serves to prevent undue competition for film, paper and other photographic goods.[958] The Council's enforcement record reflects the extraordinary range of its activities and the potency of its enforcement powers. The Promotion Council succeeded in foiling Kodak's most important promotional campaign of the 1980's, the VR Trial-Pack. Working with the JFTC, the Council determined before the campaign had even begun that Kodak's anticipated advertisement of a discount price was a misrepresentation. The JFTC summoned Kodak's representatives and issued administrative guidance to Kodak to (1) clarify the limited nature of the offer, identifying the volume of trial packs, the stores carrying them and the terms of the offer, and

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[953]The "fair trade councils" that had been previously established represented only one horizontal level of the industry, e.g., just manufacturers or wholesalers.

[954]Self-Regulation Rules Regarding Making Business Dealings with Trading Partners Fair, reprinted in Camera Times, 22 June 1982, p. 3, US Ex. 82-8.

[955]Yamada Akio, Premiums and Representations Guidance Division Director, JFTC, Suggestions on How the Fair Trade Promotion Council Should be, Zenren Tsuho, May 1983, p. 2, US Ex. 83-9.

[956]What the Fair Trade Promotion Council is Doing Now, and What it Plans to do in the Future, Zenren Tsuho, October 1983, pp. 5-6, US Ex. 83-21. Round table discussion on anonymous Promotion Council and Zenren members reported. Ibid.

[957]Self-Regulating Standards Regarding Representations Have Been Finalized, Kosei Torihiki Joho, 28 May 1984, p. 3, US Ex. 84-4. The Standards define "businesses developing" as "those who receive colour film directly from the general consumer for processing". Ibid. Promotion Council called for the promulgation of a "fair competition code".

[958]49th Zenren Conference, Iwate, General Assembly, Camera Times, 19 October 1982, US Ex. 82-11.

(2) cut back its second shipment of trial packs and announce at each store counter when the product was no longer available. Accordingly, the promotion was cut back and advertisements for the campaign were quite muted.

6.499 **Japan** submits that the JFTC was not working with the Promotion Council. There is no alignment between the JFTC and the Promotion Council, and no laws allow the JFTC to delegate its authority to the Promotion Council. In addition, the trial pack was shipped eventually in the planned volume in the VR campaign.

(ii) Retailers' Council

6.500 The **United States** further notes that in 1987, the JFTC approved the establishment of the Retailers Fair Trade Council (Retailers Council) and the Fair Competition Code Regarding Representations in the Camera and Related Products Retailers Industry (Retailers Code).[959] The Retailers Code provides the Retailers Council with authority to take enforcement actions for misrepresentations in promotions not only under the code itself, but also under the Premiums Law and related competition laws.[960] Like the Promotion Council, the Retailers Council acts as a substitute enforcement body for the JFTC in the view of the United States.

6.501 The United States points out that the Retailers Code sets forth numerous requirements for almost all forms of promotions in the photographic retail sector. The code specifies that advertised price comparisons must rely on the manufacturer's suggested retail price, the importer's suggested retail price, or the shop's normal retail price. The code restricts the use of terms like "cheapest" or "very best" unless "objective factors" can be demonstrated. Similarly, the code prohibits the use of expressions such as "super cheap", "give-away price" or "super special price" if such expressions will lead the "consumer to believe the offer is better than it actually is".

6.502 In the US view, the Retailers Code is quite distinct from the Manufacturers and Wholesalers Premiums Codes promulgated in 1965 and 1966, respectively. Unlike the earlier codes, which exclusively apply to the use of premiums, the Retailers Code governs *representations* about promotions for photo items, including film and paper.[961] The Retailers Council applies the code to promotional activities of non-members and not just businesses that agreed to adhere to the codes. This practice comports with the position of the Japanese Government that competition codes must apply industry-wide in order to have their intended effect: "there is likely to be little effect if the industry as a whole is not targeted and regulated".[962]

6.503 **Japan** argues that it is necessary to elaborate on fair competition codes or fair trade councils as none of them cover photographic film and paper. Excessive premiums and misleading representations may be found routinely anywhere in Japan. Furthermore, these activities tend to quickly spread among competitors, and to escalate in the process. It is therefore desirable for effective enforcement of the

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[959]Fair Competition Code Regarding Representation in the Camera and Related Products Retailers Industry, Kanpo, [Official Gazette] 11 April 1987, p. 1, US Ex. 87-4.

[960]Article 14.7 of the Fair Competition Code states that the RFTC shall perform "Activities pertaining to making the Act Against Unjustifiable Premiums and Misleading Representations and other laws and ordinances pertaining to Fair Trade widely understood and preventing violations thereto". US Ex. 87-4.

[961]According to the United States, the Retailers Code does not specifically limit the photographic items which fall within its scope. In the US view, the Retailers Council construes the Code as covering film and paper.

Japan notes that although the implementation rules of the Retail Industry Code specifically refer to such miscellaneous goods as tripoids or bags, they do not make any reference to such major items as film and paper and that this means that film and paper are consciously excluded.

[962]Asai Shigeo, Premiums and Representations Division, Trade Practices Department, JFTC, Protect Consumers from Misleading Representations and Advertising, Tsusansho Koho, 8 June 1971, pp. 9-19, US Ex. 71-8. See also Itoda Shogo, JFTC Secretary General, Jirei Competition Policy Law (15 December 1995), pp. 420-21, US Ex. 95-20.

Premiums Law to have business entities agree on self-restraint of such behaviour and to prevent actual violation of the Law. It is against this background that Article 10 of the Law allows business entities to adopt, subject to the JFTC's approval, voluntary rules on premiums and representations, to ensure consumers' proper selection of merchandise and fair competition in the market.

(iii) Coverage of photographic materials

6.504 Japan emphasizes that no fair competition code covers photographic film and paper and that observance of the "spirit of the code", as provided for in the Retailers' Code, may not extend to items not included in the "camera category". Even if the industry were to decide to expand the scope of the codes to include these products, such a decision has no impact on the operation of the Premiums Law, or the Antimonopoly Law, unless it is approved by the JFTC.

6.505 Given that there is no fair competition code applicable to the photographic film or paper, Japan argues that thus the JFTC's approval has not in any way nullified or impaired the benefits of concessions for the United States in respect of these products. More fundamentally, a non-violation claim against JFTC approval of fair competition codes raises no particular issue distinct from the issues surrounding the regulation under the Premiums Law and JFTC Notifications because the JFTC does not approve any code which is inconsistent with the regulation. Therefore, Japan concludes that as long as no nullification or impairment results from the content of the JFTC regulation, the JFTC approval does not nullify or impair benefits of Japan's trading partners.

6.506 With respect to Japan's contention that the codes and councils do not regulate the sale or promotion of photographic materials and that the codes were not *drafted* with film or paper in mind, the **United States** responds that the *actual* market effects these codes and councils is to stultify promotions for photographic materials in the Japanese market, and that it is this *actual* effect to which the United States objects.

6.507 For the United States, the evidentiary record reflects the relationship between the codes and photographic materials. In the case of the Promotion Council, e.g., its 1984 Self-Regulating Measures provide that they cover "DP representations", or "representation[s] of the photo processing fee for colour negative film".[963] With respect to the Retailers Code, its language provides an ample basis for the widespread perception among retailers that it in fact applies to film and development or processing. The United States points out that Article 2.2 of the Retailers Code provides that "[t]o attain the objectives outlined … above … businesses are to respect the spirit of this code even when the products being dealt with do not correspond exactly to Cameras and Related Products". An industry member explained, it would "indeed have been impossible to persuade *Zenren* members whose main line of business is development printing to contribute if [the regulations] only [apply to] hardware".[964]

6.508 **Japan** argues that the statement of the Secretary General of Zenren in the same article ("I will endeavour to make both photosensitive materials and development printing fall under the code") should be understood as an expression of will to extend the code to film and paper which presently do not fall under the coverage.

6.509 The **United States** believes that it is irrelevant whether the codes and councils govern film and paper *de jure* or *de facto*. What does matter is that Japan has organized the most powerful elements of its domestic photographic industry and allowed them to set standards on how products in their sector may be promoted. The United States contests Japan's statement that rules adopted by Japan's leading

[963]Self Regulating Standards Regarding Representations of Developing Fees for Negative Colour Film have been Finalized, Kosei Torihki Joho, 28 May 1984, p. 3, US Ex. 84-4.

[964]Discussion of Progress of Fair Trade Council Focuses on Making Fair Competition Code Fully Known, Zenren Tsuho, August 1987, p. 3, US Ex. 87-7. Japan contests the correctness of this translation. See translation issue 18.

photographic retailers or wholesalers, which govern the promotion of almost every item these businesses sell, will have no effect on film and paper.[965] In the US view, Japan has invited its photographic industry to devise and enforce rules in their self-interest, and obvious market realities associated with such extraordinary industry cooperation should not be ignored.

(d) Conclusions

6.510 The United States argues that Japan liberalization countermeasures directed against wholesalers and retail stores through a series of promotion restrictions have disadvantaged imported foreign photographic material manufacturers by constraining their ability to increase sales through the use of gifts, prizes and other economic inducements, or to rely upon innovative advertising campaigns, particularly where price or price comparisons are discussed. The United States alleges that Japan imposed these countermeasures for the purpose of dampening import competition and, to ensure their success, enlisted the aid of the domestic photographic materials industry in enforcing the regime.

6.511 **Japan** claims that there is no measure in the Premiums Law, JFTC Notifications or other JFTC regulations which nullifies or impairs benefits accruing to the United States. Accordingly, in Japan's view, the United States has not demonstrated the relevant conditions to substantiate its non-violation claim.

[965]The United States questions that promotions otherwise banned would be welcomed by members of a "fair trade council" simply because they are used, e.g., for film instead of a tripod or camera bag.

E. REASONABLE ANTICIPATION

1. THE LEGAL TEST

6.512 The **United States** claims that it negotiated in three separate rounds of multilateral trade negotiations for tariff concessions from Japan in the photographic materials sector. At each point in time that it received a tariff concession from Japan, the United States had a reasonable expectation, based on the "pertinent facts available" at the time of the negotiation, that Japan would not take future action to nullify or impair the concession. The United States emphasizes that there were no facts of which the United States reasonably "should have been aware" concerning measures that the Japanese Government may have taken prior to the conclusion of a tariff negotiation that thereafter nullified or impaired the concessions.

6.513 The United States recalls that the *EEC - Oilseeds* panel found that parties negotiating tariff concessions, a principal benefit of which is the opportunity for improved price competition with respect to domestic products, may be assumed not to anticipate actions by the country granting the concession that offset the price advantage to result from the tariff reduction:

> "The Panel considered the main value of a tariff concession is that it provides an assurance of better market access through improved price competition. Contracting parties negotiate tariff concessions primarily to obtain that advantage. They must therefore be assumed to base their tariff negotiations on the expectation that the price effect of the tariff concessions will not be systematically offset".[966]

6.514 Further, the 1961 Panel Report on *The Operation of the Provisions of Article XVI* explained that a party's reasonable anticipation would be evaluated in light of the "pertinent facts available" at the time it negotiated the tariff concession.

> "By this the Panel understands that the presumption is that unless such *pertinent facts were available* at the time the tariff concession was negotiated, it was then reasonably to be expected that the concession would not be nullified or impaired by the introduction or increase of a domestic subsidy."[967]

6.515 The United States further submits that the panel on *EEC - Canned Fruit* approached the issue of reasonable anticipation with respect to measures that existed prior to the conclusion of the tariff negotiations by asking whether the country receiving the concessions "should have been aware" of the measures in question such that it "should have taken due account of [them] in negotiating concessions" with respect to the relevant products.[968]

6.516 **Japan** contends that, although the United States tries to assume the burden of proof away by incorrectly quoting precedents for over broad propositions, interpreted properly, the precedents cited by the United States do not support its position. In the 1961 Panel Report on *the Operation of the Provisions of Article XVI*, the terms of reference were quite specific in referring to "subsidies" and a few other specific policy issues. Japan's notes that the following passage reveals important limitations on exactly what parties can be held to reasonably assume:

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[966]*EEC - Oilseeds*, BISD 37S/86, 128-131, para. 148; paras. 149-150.

[967]Panel Report on *Operation of the Provisions of Article XVI ("Operation of Article XVI")*, adopted on 21 November 1961, BISD 10S/201, 209, para. 28.

[968]*EEC - Canned Fruit*, GATT Doc. L/5778, p. 29, para. 79 (unadopted).

> "So far as domestic subsidies are concerned, it was agreed that a contracting party which has negotiated a concession under Article II may be assumed for the purpose of Article XXIII, to have a reasonable expectation, failing evidence to the contrary, that the value of the concession will not be nullified or impaired by the contracting party which granted the concession by the subsequent introduction or increase of a domestic subsidy on the product concerned".[969]

6.517 For Japan, it is thus clear that this panel report hardly establishes the kind of general principle which the United States claims, but rather reflects a very specific concern about domestic subsidies granted to products that had been subject to tariff concessions. Moreover, this language also makes clear that the domestic subsidy must be introduced or increased subsequent to the tariff concessions relevant in this context. The same limitations existed in the *EEC - Oilseeds* panel: the measures at issue in that case were product-specific domestic subsidies introduced subsequent to the relevant tariff concessions.[970] The finding of the *EEC - Oilseeds* panel about the assumption of reasonable expectations has to be understood in the specific factual context of that case.

6.518 The **United States** accepts that a number of prior panel reports have inquired whether a product-specific subsidy was introduced or increased subsequent to the tariff negotiations.[971] However, the United States submits that the current dispute is not about product-specific subsidies, which are easy to detect and whose effects are easy to predict. The United States emphasizes that a Member cannot be held to the same standard of knowledge about non-transparent, non-traditional and often non-sector-specific measures as for product-specific measures. But, the United States rejects Japan's characterization of the factors and findings in the *EEC- Oilseeds* dispute. In that case, the panel rejected the EC's argument that the existence of some measures at the time of the tariff concession -- which were later substantially enhanced -- meant that the United States could or should have reasonably anticipated their modification or enhancement.[972]

6.519 As to the issue of the kind of knowledge that forms the basis of legitimate expectations with respect to the relevant tariff concessions, **Japan** explains that the "reasonably anticipated" requirement recognizes that trade negotiations do not take place in a vacuum; countries bargain against a background of their own and other countries' policies and economic conditions, i.e., past, present, and anticipated in the future. Expectations concerning this background shape the concessions that are offered and those that are accepted. It is therefore reasonable to assume that countries take into account other countries' past, present, and anticipated future policies when negotiating trade concessions.

6.520 Accordingly, participants of the type of negotiations stipulated by Article XXVIII*bis* of GATT should be deemed to have taken into account all existing policies and measures, as well as all policies and measures that could be reasonably anticipated at that time, when negotiating the tariff concessions. For Japan it follows that countries should not be allowed to claim nullification or impairment by reason of measures or policies that already existed or could have been reasonably anticipated at the time when the relevant tariff concession, i.e., the 1994 Uruguay Round tariff concessions, were made. In Japan's view, its interpretation is consistent with the findings of the *EEC - Oilseeds* panel, which held that

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[969]Panel Report on *Operation of Article XVI*, op. cit., para. 27.

[970]The *EEC - Oilseeds* panel found that "the case before it does not require the Panel to address the question of whether the assumption created by the 1955 decision of the CONTRACTING PARTIES applies to all production subsidies, including generally available subsidies serving broad policy objectives … [a]t issue in the case before it are product-specific subsidies ."… *EEC - Oilseeds*, BISD 37S/86, 128, para. 148.

[971]The *Australia - Ammonium Sulphate* and *German - Sardines* decisions did not involve product-specific subsidies. *See Report of the Working Party on the Australian Subsidy on Ammonium Sulfate*, adopted 3 April 1950, BISD II/188-196, para. 12; Panel on *Treatment by Germany of Imports of Sardines*, G/26, adopted 31 October 1952, BISD 1S/53-59, paras. 16-17.

[972]*See, e.g., EEC - Oilseeds*, paras. 81 and 149.

whether or not the measures at issue could have been reasonably anticipated by the complaining party is one of the important elements in the examination of a non-violation complaint.[973]

6.521 For the **United States**, there are two compelling reasons why Japan's "reasonably anticipated" test should be rejected:

a. First, there is no textual basis for such a rule in the General Agreement. Article XXIII:1(b) refers to "the application … of any measure, whether or not it conflicts with the provisions of this Agreement." In the US view, the drafters' selection of the term "any measure" evidences their intent that Article XXIII:1(b) be read to address all situations in which a Member believes that benefits accruing to it under the General Agreement have been nullified or impaired by another Member's measures. Therefore, the United States concludes that the ordinary meaning of Article XXIII:1(b) does not provide a basis for Japan's argument that any measure should be excluded from consideration that existed - or is related to a measure that existed - prior to the time at which the Final Act of a multilateral tariff negotiation is signed.

b. Second, it is well established that "a contracting party which has negotiated a concession under Article II may be assumed, for the purpose of Article XXIII:1(b), to have a reasonable expectation, failing evidence to the contrary, that the value of the concession will not be nullified or impaired by the contracting party which granted the concession … ".[974] The Member receiving the concession is entitled to this presumption "unless such pertinent facts were available at the time the tariff concession was negotiated" that would undermine this expectation.[975]

6.522 The United States submits that the criteria developed in GATT jurisprudence on the issue of what kind of knowledge forms the basis for legitimate expectations follow a fundamental and practical logic: So long as Members are aware of the "pertinent facts" concerning measures of other Members, "there is nothing to prevent [them], when they negotiate reduction of tariffs, from negotiating on matters … which might affect the practical effects of tariff concessions".[976] By contrast, in the US view, if the "pertinent facts" are *not* available, parties cannot be expected to address them during tariff negotiations. Nor can Members be expected to conduct extensive research on each tariff item to determine whether there are measures that could reasonably be expected to nullify or impair. The United States submits that, as the *EEC - Canned Fruit* panel found, the issue is whether and to what extent the country receiving the concessions "should have been aware" of the measures in question such that it "should have taken due account of [them] in negotiating concessions" with respect to the relevant products.[977]

6.523 According to **Japan**, there is no precedent or decision to support the US theory that the lack of knowledge of certain pre-existing "measures" by the complaining party leads to a conclusion that a balance of tariff concessions needs to be adjusted when new knowledge is acquired:

a. The panel on *EEC - Oilseeds* only dealt with a case where the measures at issue were introduced subsequent to the relevant tariff concessions and not a case about pre-existing measures;

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[973]Ibid., p. 129, para. 149.

[974]Ibid., p. 127, para. 147. Working Party Report on *Other Barriers to Trade*, adopted on 3 March 1955, BISD 3S/222, 224, para. 13.

[975]Working Party on *Operation of Article XVI*, BISD 6S/201, 209, para. 28. The presumption was established for and has been applied only in non-violation cases involving subsidies. The logic of the presumption, in the US view, should also apply to a non-violation case involving any type of measure: the complaining party should only be held to knowledge of measures for which pertinent facts were available at the time of the negotiation.

[976]See *Operation of Article XVI*, op. cit., para. 28, citing Working Party on Other Barriers to Trade, op. cit., para 14.

[977]*EEC - Canned Fruit*, GATT Doc. L/5778, p. 29, para. 79 (unadopted).

b. The 1955 Working Party Report on *Other Barriers to Trade*[978] made it clear that the domestic subsidy must be introduced *subsequent* to the relevant tariff concessions in this context;

c. The 1961 Panel Report on *Operation of the Provisions* of Article XVI[979] also dealt with the reasonable expectation that the concession would not be nullified or impaired by a subsequent measure (i.e., the introduction or increase of a domestic subsidy in that case);

d. The 1985 panel on *EEC - Canned Fruit,*[980] which is unadopted, is the only precedent that dealt with a measure that already existed at a time of a tariff concession under consideration. However, that panel found that the complaining party should have been aware of the existence of the measure, and not that a complaining party was excused from being presumed to have knowledge about a pre-existing measure.

6.524 More generally, Japan contends that the United States tries to shift the burden of proving that it could not have reasonably anticipated the alleged measures at issue. Japan emphasizes that it is the United States that bears the burden of proving that the challenged measures were not reasonably anticipated at the time of the tariff concessions.

6.525 The **United States** does not disagree that the complaining party has the initial burden of showing that it did not reasonably anticipate the challenged measures at the time of the tariff concessions. The United States has made such a showing in this case based on the pertinent facts available at the time of each negotiation. However, the responding party, in order to prevail, must provide firm evidence rebutting the complaining party's demonstration that it was not aware of pertinent facts that would have altered its reasonable expectations. If that were not the case, complaining parties would bear the burden of proving why they should not have anticipated that the defending party would implement its tariff concessions in bad faith. A party receiving a tariff concession does not and should not have to prove why it did not assume that the party granting a tariff concession would frustrate the value of those tariff concessions.

6.526 The United States explains that information on the existence of many of the individual measures at issue in this case was not "available" because it was not printed in sources that governments typically use to announce trade policies or to which trade negotiators or foreign business persons typically have access. Even if trade negotiators could have, with extensive efforts, identified and located some of the measures, they could not have developed a coherent picture of the group of measures because they were issued in dozens of sources ranging from the reports of government-industry committees on which no foreigners served to articles in industry association journals available to the association's predominantly Japanese membership. The United States emphasizes that it is exactly the interrelationship between these measures that deprives foreign producers of market access.

6.527 **Japan** rejects the US argument that it could not have known the additional, combined effects of the measures at issue, given that, in Japan's view, the United States admitted that it was aware of the existence of many of the measures and their alleged general effects. In response to the US notion of measures "working together," Japan points out that the US argument on this point is not specific and that, in Japan's view, nothing "working together" with nothing is still nothing.

6.528 For the **United States**, in determining what measures it should have been aware of before entering into tariff negotiations with Japan or what measures the United States should have anticipated that Japan would impose after the tariff negotiations, it is important to consider the nature of the

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[978]Working Party Report on *Other Barriers to Trade*, op. cit., para. 13.
[979]Panel Report on *Working Party on the Operation of the Provisions of Article XVI*, op. cit., p. 224, para. 28.
[980]*EEC - Canned Fruit*, GATT Doc. L/5778, (unadopted).

measures. In the US view, the type of measures at issue in this dispute are dramatically different - and substantially harder to detect and comprehend - than the product-specific subsidies at issue in prior Article XXIII:1(b) disputes.[981] The United States explains that the individual measures used by the Japanese Government to implement its countermeasures program are not the kinds of measures countries would normally examine to determine whether tariff concessions might be nullified or impaired. According to the United States, Japan's measures are not the types of trade instruments that have typically been used by governments to restrict the benefits flowing from tariff concessions, are not labelled trade instruments, and could not be found in statutory compilations of typical trade instruments, such as subsidies, anti-dumping measures, other customs measures or safeguards.

6.529 **Japan** disagrees with the US argument that it could not have anticipated the Japanese measures in question because they are hard to detect and comprehend by virtue of their nature, because of the publicity of the alleged measures in this case, US concerns about them expressed in the National Trade Estimates Reports and bilateral discussions during the late 1980s and the first half of the 1990s. Japan further argues that it is reasonable to assume that US trade negotiators are in communication with representatives of their exporting industries.[982] Industry representatives are fully aware of industry-specific trade barriers, real or imagined, and are fully capable of communicating any concerns they have. Trade negotiators are, and should be deemed to be, well-equipped to judge whether existing policies or market conditions are likely to undermine the value of a particular tariff concession offer. Accordingly, in Japan's view, the US argument that trade negotiators should be presumed unaware of published documents and publicly known facts is unconvincing.

6.530 The **United States** underscores that most of these measures are neutral on their face. Thus, assuming that trade negotiators had the insight to understand the singular nature of government regulation of business in Japan and had time to examine these measures of law, even then, they would likely not have understood the measures' role and effect. In addition, the United States points out that many of the measures were not sector-specific and were issued in literally dozens of sources, ranging from the reports of government-industry committees on which no foreigners served, to articles in industry association journals available to the association's predominantly Japanese membership. Even if, with extensive efforts, trade negotiators had been able to identify and locate these measures, they would not have been able to understand how the measures operated generally in the Japanese economy as a whole, let alone how the countermeasures worked specifically in the photographic materials sector.

6.531 **Japan** emphasizes that all of the US allegations in this case, (i) that single-brand distribution impedes imports, (ii) that the Large Scale Retail Store Law impedes imports, and (iii) that regulations under the Premiums Law impede imports, have been applied generally to products across the board, and these general concerns were clearly on the minds of US trade negotiators during the Uruguay Round. In Japan's view, the United States cannot have formed some legitimate expectation that its concerns - assuming that they were valid - would not apply to film and paper among other products.[983]

6.532 The **United States** requests the panel to direct its inquiry at whether the United States was aware, or should have been aware of the effects of an existing measure, or could have anticipated the effects of a new measure, on the specific products or tariff concessions under consideration, taking

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[981]*See EEC - Canned Fruit*, GATT Doc. L/5778, p. 18, para. 52 (unadopted) (finding that the United States should have been aware of a subsidy granted on canned peaches in May 1978 prior to the conclusion of the Tokyo Round in June 1979, and taken due account of this in the negotiations).

[982]Japan notes that the United States documented that US trade negotiators were in communication with Kodak during the Tokyo Round negotiations.

[983]Japan notes that the United States itself stressed its long held and deep interest in this sector in its submissions to this Panel: "During the Tokyo Round, the United States once again attached a high priority to negotiating tariff concessions on photographic film and paper from Japan." "The value that the United States placed on obtaining tariff concessions on photographic film and paper… is evident from its continuing efforts to secure improved access to the Japanese film and paper market during three successive rounds of multilateral trade negotiations."

into account all relevant facts and circumstances. These include, (i) the nature of the measure (i.e. whether it is product-specific like a subsidy or more generic like Japan's Premiums Law and Large Stores Law), (ii) the manner in which the measure was promulgated and publicized, and (iii) the way in which the measure operated in conjunction with other measures. The United States explains that the complaining party's knowledge of a measure and its effect on the specific products under negotiation is relevant in determining what benefits the complaining party could reasonably have expected to flow from the tariff concessions for which it bargained. For example, a complaining party should have lesser expectations if, at the time of the negotiations, it has knowledge of a measure - or can predict the introduction of a measure - and its effect on the benefits flowing from a tariff concession.

6.533 **Japan** emphasizes that the effects of the measures should be irrelevant to the reasonable anticipation test. An examination of whether the effects of the measures, including potential effects, are reasonably anticipated could, in Japan's view, lead to subjective and arbitrary judgements on the content and the extent of the effects to be anticipated. The benefit of tariff concessions under Article II is not the actual economic result of tariff concession (i.e., import volumes), but the expectation of improved competitive conditions for imports. For Japan, it would thus be inappropriate to try to judge the effects of the measures at issue in light of actual trade results when determining the existence of "reasonable anticipation".

6.534 Japan further advocates a clear and stable standard of judgement in examining whether or not to allow the alleged lack of knowledge of certain measures by the complaining party to justify a non-violation complaint. To this end, the evaluation of whether a certain measure could have been reasonably anticipated or known should be determined based not on the "subjective" criteria of whether a particular government at a particular time could have anticipated or known the measure at issue, but rather on objective criteria, such as degree of publicity of the measure.

6.535 The **United States** underscores that negotiators from other countries in the Kennedy, Tokyo, or Uruguay Rounds could not discern whether the distribution countermeasures, Large Stores Law, and the promotion countermeasures would disrupt the flow of benefits flowing from market access commitments. In the view of the United States, to require Members in the midst of ongoing multilateral tariff negotiations to undertake the type of investigation and analysis that would have been necessary to uncover the individual elements of Japan's liberalization countermeasures and the nature and scope of the scheme as a whole, would fundamentally undermine the process of tariff negotiations under Article II of GATT. If this were the standard, the United States suggests that no negotiator could ever be sufficiently certain that a concession would not be nullified or impaired to accept such a concession. In particular, the United States stresses that a Member should not be required to assume that all measures existing at the time of a tariff negotiation have the potential to nullify or impair specific tariff concessions or to anticipate that the party granting the tariff concession will introduce new measures to nullify or impair its concessions. For the United States, such an approach would imply that WTO Members should assume that tariff concessions are not negotiated in good faith.

6.536 **Japan**, in turn, requests the Panel to apply strictly the criterion of reasonable anticipation. Otherwise, there would no longer be any security in the balance of tariff concessions, since the non-violation remedy would expose tariff bargains to constant attack on the ground that certain Members had insufficient understanding of what they were doing when they accepted other Members' trade concessions. In that event, Japan argues, Article XXIII:1(b) would be rendered perversely self-defeating. In Japan's view, a provision designed to preserve the integrity of tariff concessions would instead become an instrument for undermining it.

6.537 According to the **United States**, Japan has argued that the United States knew or had reason to know of some of the discrete elements of the liberalization countermeasures and, therefore, its non-violation argument fails. The United States acknowledges that over time other countries have become aware of conditions in Japan other than tariffs that pose obstacles to imported products. However,

the United States did not understand, until it began to prepare this case in the WTO, and only through extensive research did it come to understand that the Japanese Government played a central role in closing the distribution system. Nor was the United States aware that Japan used other measures affecting wholesaling, retailing and marketing to prevent foreign products from circumventing the closed distribution system.

6.538 **Japan** responds that the United States gives no reason why, after it has been unable to acquire the requisite knowledge for the past two decades or more, the clouds have suddenly lifted the end of the Uruguay Round, revealing everything to it and allowing it to bring its complaint.

6.539 The **United States** maintains that Japan acted at the end of each negotiating round to establish, reinforce, and substantially enhance measures that caused the systematic exclusion of imports from key distribution channels. The United States points out that it took extensive investigation and review of thousands of documents from a wide variety of seemingly unrelated sources to piece together and understand the full import of Japan's actions. In the US view, for these actions to be now excused on the basis that other parties should have known about or anticipated its actions would undermine confidence in the tariff negotiating process under Article II.

6.540 In **Japan's** view, the US approach would overburden and possibly halt a tariff negotiation process, because the party granting the concessions would feel compelled to present in detail to the other parties to the negotiation extensive information regarding any policy and any action which could otherwise be used for future non-violation claims. In this regard, Japan argues that while the presumption of the lack of knowledge of measures on the part of a complaining party may be established for such measures as domestic subsidies introduced subsequently to the tariff concessions, measures which already existed at the time of tariff concessions, especially those which were publicly known, should be deemed to be known by the party receiving the tariff concessions.

6.541 Japan requests the Panel to reject the US non-violation claims because the United States could reasonably have anticipated the alleged measures at the time of the 1994 tariff concessions. For Japan it is clear that the United States could have reasonably anticipated the particular Japanese policies at issue in this case at the time the respective tariff concessions were being made. Accordingly, Japan contends that the United States has not met its burden of providing a "detailed justification" for its claims under Article 26.1(a) of the DSU.

2. SPECIFIC NEGOTIATING ROUNDS ON TARIFF CONCESSIONS

(a) General overview

6.542 The **United States** declares that at each point in time it received a tariff concession on consumer photographic film and paper from Japan (i.e., in the Kennedy Round, Tokyo Round and Uruguay Round), the United States had a reasonable expectation, based on the "pertinent facts available", that Japan would not impose measures to nullify or impair the concessions. The United States asserts with respect to the measures Japan applied subsequent to each round, there were no facts available that would have enabled the United States reasonably to anticipate those actions would undermine the concessions. The United States is convinced that following the Kennedy, Tokyo and Uruguay Rounds, with respect to Japan's ongoing application of certain measures neither the United States nor any other contracting party either should or could have been aware of the existence or operation of these measures such that it "should have taken due account of [them] in negotiating concessions".[984]

[984] *EEC - Canned Fruit*, op.cit., p. 29, para. 79.

6.543 As to the issue of the kind of knowledge that forms the basis of legitimate expectations with respect to the relevant tariff concessions, **Japan** argues that for US expectations to be legitimate in this context, they must have taken into account all of Japan's measures that could have been reasonably anticipated at the time the 1994 *Uruguay Round* tariff concessions were made.

6.544 In the alternative, if the Panel decides that the 1994 Uruguay Round tariff concessions were not the only concessions relevant to this case, Japan contends that the US non-violation claims remain flawed by threshold timing problems.

6.545 As to the *Tokyo Round*, Japan argues that almost all of the alleged measures in dispute occurred before the 1979 Tokyo Round tariff concessions, which were the first tariff concessions on colour film and paper. In Japan's view, those alleged measures that occurred subsequently should have been reasonably anticipated by the United States. Accordingly, for Japan there are no alleged measures in dispute that are capable of nullifying or impairing benefits accruing with respect to colour film or paper. All that remains is black and white film and paper, which currently comprise less than two percent of the total Japanese consumer photosensitive materials market.[985]

6.546 With respect to the *Kennedy Round*, Japan further admits that many of the alleged measures in dispute occurred after the 1967 tariff concessions on black and white film and paper.[986] Nevertheless, according to Japan, even these alleged measures were "outgrowths" of previously announced policies, and thus should have been reasonably anticipated by the United States. Consequently, in Japan's view, even if expectations concerning earlier tariff concessions remain protected, the US non-violation claims cannot meet the first basic requirement, i.e., a "benefit" of legitimate expectations capable of being nullified or impaired.

6.547 The **United States** responds that all of Japan's tariff concessions - in the Kennedy, Tokyo and Uruguay Rounds - are relevant. Japan's liberalization countermeasures were 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. The tariff concessions the United States received from Japan tracked this progression of the market.[987]

6.548 In the view of the United States, Japan is arguing, in effect, that the United States should have known that Japan was nullifying or impairing its Kennedy Round tariff concessions, and should have anticipated that it would continue nullifying or impairing its subsequent tariff concessions in the Tokyo and Uruguay Rounds on photographic film and paper. In the understanding of the United States, Japan suggests that a Member is deemed to have knowledge of any measure that existed - or is related to a measure that existed - prior to the time at which the Final Act of a multilateral tariff negotiation is signed, and to anticipate that such measures would undermine the tariff concession.

(b) Kennedy Round

6.549 **Japan** submits that the Kennedy Round was formally concluded on 30 June 1967. All substantive negotiations were finished at the last minute.[988] During the Kennedy Round, Japan accepted bound tariff reductions for black and white film and paper, but made no concessions at all with respect to colour film or paper. Thus, the Kennedy Round is only relevant at all if the alleged measures nullified

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[985]Photo Market 1996, p. 55, Japan Ex. A-1.

[986]There were no Kennedy Round concessions on colour film or paper. Japan notes that the first US submission incorrectly indicates that there were bound tariff concessions on colour film and paper in the Kennedy Round, but that the second US submission correctly indicates the absence of any bound tariff concessions.

[987]See also paras. 2.2, 2.4, 5.26 and 6.43, above.

[988]See Gilbert Winham, International Trade and the Tokyo Round Negotiation (1986), p. 77-78 (noting EC internal difficulties that prevented any serious negotiations from starting until January 1967), Japan Ex. E-6.

or impaired the concessions related to black and white film and paper. Moreover, Japan recalls that black and white film and paper only represent about 2 percent of the present Japanese market. Thus, to the extent the Kennedy Round is relevant to this case, it is only relevant to a trivial portion of the products at issue. However, foreign brands have represented as much as 40-50 percent of the market.

6.550 The **United States** claims that during the period 1964 to 1967, there were no pertinent facts available to negotiators from the United States or any other GATT contracting party that challenged their reasonable expectations that Japan would not nullify or impair Japan's Kennedy Round concessions on photographic film and paper. At the time of the Kennedy Round negotiations, (i) Japan had not articulated a clear policy of distribution systemization; (ii) had not determined that it would aggressively limit the expansion of large stores; and (iii) had not indicated it would use restrictions on economic inducements to prevent foreign enterprises from penetrating the Japanese market. Nor was there any reason that the US Government should have known that the Japanese Government would take such actions at the conclusion of the Kennedy Round.[989]

(i) Distribution "countermeasures"

6.551 **Japan's** notes that two items listed by the US preceded the tariff concessions of the Kennedy Round:

(i) 1967 Cabinet Decision; and
(ii) JFTC Notification 17 (1967).

6.552 First, Japan explains that the 1967 Cabinet Decision was adopted on 6 June 1967, before the final agreement concluding the Kennedy Round agreement on 30 June 1967. The Cabinet Decision ratified public debate from the preceding two years and clearly endorsed distribution modernization as a way to remedy inefficiency and prepare for imminent capital liberalization. Second, the JFTC issued Notification 17 in May 1967, even earlier than the 1967 Cabinet Decision.

6.553 The **United States** responds that at the time of the Kennedy Round negotiations, there were no pertinent facts available concerning the actions Japan was preparing to take to implement its liberalization countermeasures program. The 1967 Cabinet Decision, which approved the use of countermeasures to prevent foreign enterprises from penetrating the Japanese market through key distribution channels, had yet to be promulgated and implemented. The United States argues that Japan had not articulated a clear and coordinated systemization policy to block access to primary wholesalers.

6.554 In the US view, the Japanese Government's array of opaque, informal measures to implement the systemization policy could not have been foreseen:

(i) 1969 Survey Report on Transaction Terms;
(ii) 1970 Guidelines;
(iii) 1971 Basic Plan;
(iv) 1975 Manual;
(v) JDB funding for Konica's wholesalers (which commenced in 1976);
(vi) SMEA funding for photo processing laboratories (first designated in July 1967).

6.555 According to **Japan**, while the items listed by the United States occurred after the 1967 concessions, the following items were an "outgrowth" of MITI's ongoing distribution modernization policies aimed at rationalization of transaction terms and systemization of distribution practices:

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[989]See also paras. 5.26 and 6.339 above. For the US response to Japan's arguments concerning Japan's tariff concessions on colour, and black and white film and paper, see para. 6.337-6.338 in the sub-section VI.D.3.(c).(v). on "Black and white film and paper" above.

(i) the 1969 Survey;
(ii) the 1970 Guidelines; and
(iii) the 1971 Basic Plan;
(iv) the international contract notification requirement.

6.556 In Japan's view, the same holds true for the interim reports of the Distribution Committee, and the first and second interim reports of the Distribution Committee of 1964 and 1965, respectively, which also endorsed modernization of the distribution sector. Japan points out that these reports were published in the MITI Gazette, a widely read official MITI publication. Japan explains that the 1967 Cabinet Decision, which occurred before the conclusion of the Kennedy Round and almost a year prior to the Japanese acceptance of the Kennedy Round package, clearly embraced distribution modernization as a necessary response to imminent capital liberalization. Japan point out that this decision was published and widely publicized. For Japan, it is inconceivable that the United States Embassy in Tokyo would not have watched closely how Japan resolved the high-profile debate about capital liberalization that had been taking place in 1966 and 1967. Japan further argues that the requirement for international contract notification also took place prior to the conclusion of the Kennedy Round. Although the United States cites a minor change in 1971, the requirement for international contract notification itself goes back to 1953. Therefore, Japan concludes that the United States should have reasonably anticipated that the Japanese Government would continue to pursue these policies.

6.557 Japan also submits that SMEA financing predates the conclusion of the Kennedy Round. According to Japan, under SMEA financing, whose general framework was established in 1956, photofinishing laboratories were designated as an eligible industry on 1 April 1967.[990] This specific financing program to photofinishing laboratories thus predated the Kennedy Round deal. In Japan's view, the United States could not have had any legitimate expectation that financing would not be granted to qualifying applicants in the photographic sector.

6.558 Even assuming that MITI's distribution modernization policies during the 1960s and '70s encouraged single-brand distribution of film and paper as a means to exclude foreign brands from traditional distribution channels, for Japan it is clear that these trends began well in advance of the conclusion of the Kennedy Round. As to *film*, Japan argues that two of Fuji's four primary wholesalers were already single-brand dealers, as were all of Konica's primary wholesalers that eventually became subsidiaries. Japan claims that the United States should have been aware of this trend, since Fuji's third primary wholesaler, Misuzu, terminated its dealings with Kodak in April 1967, months before the final Kennedy Round deal. Similarly, Kodak's distributor in Japan, Nagase, acquired Kuwada in 1967, and converted Kuwada into a single-brand distributor. Kodak not only knew of the trend, Kodak was part of the trend. Public press accounts documented the trend toward single-brand distribution for film as well as cameras. As early as 1964, trade publications were already noting the trend toward single-brand wholesale distribution.[991] As to *paper*, Japan submits that affiliations between manufacturers and photofinishing laboratories were already common by 1967.[992] In Japan's view, the United States could not have any legitimate expectation that these trends would not continue.

6.559 The **United States** claims that Japan did not articulate, let alone implement, a clear and coordinated systemization policy to block access to primary wholesalers until after the Kennedy Round had concluded, that none of its subsequent actions was foreseeable to Japan's negotiating partners during

[990]According to Japan, the United States alleges that the date was July 1967. Japan contends that the designation date was in fact 1 April 1967, an extremely common date for such designations in Japan, since 1 April marks the start of a new fiscal year for the government.

[991]Distribution Keiretsu Gaining Strength - As Shown by Fuji's Special Contract (Tokuyakuten) Shops, Zenren Tsuho, May 1964, p. 5, US Ex. 64-3.

[992]According to domestic industry sources, these affiliations began as early as 1960 and were relatively common place by 1965. Affidavit of Tanaka Takeshi, p. 3, Japan Ex. A-10.

the Kennedy Round and that these actions have been difficult to uncover, identify and understand even with the benefit of intensive and unprecedented investigation and 25 years hindsight.

(ii) Restrictions on large stores

6.560 The United States claims that at the time of the Kennedy Round negotiations,

(i) the Large Stores Law had not yet been proposed; and
(ii) MITI's two key directives, which laid the foundation for the law by expanding the scope of the Department Store Law, were not issued until June 1968 and September 1970, respectively.

6.561 **Japan** responds that the enactment of the Large Stores Law in 1973 and subsequent amendments in 1978 and up to today, while subsequent to the Kennedy Round, have represented the continuation of a longstanding policy of preserving retailing diversity through regulation of large stores. Specifically, the Department Store Law was enacted in 1956, and required new department stores to obtain permits before opening. According to Japan, the Large Stores Law merely represented an extension of this preexisting regulatory policy to other types of large stores that were starting to arise (e.g., supermarkets, discount stores) and to block the deliberate circumvention of the law. Japan argues that the United States could not have had any legitimate expectation that large stores would be allowed to displace small and medium-size retailers in the absence of any government adjustment process.

6.562 Moreover, in Japan's view, the currently existing Large Stores Law is more liberal than the Department Store Law for the following reasons: First, the former substituted a notification system for the latter's permission-based system. Second, the former's regulations on store holiday and closing hours are less restrictive than the latter's.[993] Third, while only 84 percent of applications were permitted and implemented under the Department Store Law, approximately 96 percent of notified plans are implemented under the Large Stores Law. Therefore, Japan concludes that even if it were accepted that restrictions on large retail stores are unfavourable to imported products, there is nothing unfavourable to the imports that the United States could not have anticipated at the time of the Kennedy Round tariff concessions.

(iii) Promotion "countermeasures"

6.563 The **United States** argues that, at the time of the conclusion of the Kennedy Round, Japan's decision to use fair competition codes as an "effective countermeasure" was just about to be announced and implemented.[994] There was no reason why the United States could or should have known that Japan was about to take these actions which resulted in nullification or impairment of its Kennedy Round tariff concessions.

6.564 **Japan** submits that the Premiums Law was enacted in 1962. This law targeted conduct that had been identified by the JFTC as unfair trade practices as early as 1953. According to Japan, Notifications 5 and 34 merely represented elaborations of the general norms set forth in the Premiums Law. The 1972 amendments granted enforcement authority to prefectural governments. Japan contends that all of these developments should have been reasonably anticipated by the United States, since the United States had no legitimate basis for expecting that excessive premiums and deceptive advertising would go unregulated, or that this regulation would not be enforced vigorously.

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[993]Japan notes that, under the Department Store Law, the minimum number of store holidays without permission was 48 days (4 days a month) for urban areas and 24 days (2 days a month) for other locations for a year.

[994]Report of the Foreign Investment Council Expert Committee, reprinted in Finance, June 1967, p. 3, US Ex. 67-5.

(c) Tokyo Round

6.565 **Japan** submits that the Tokyo Round was formally concluded on 11 July 1979. The Tokyo Round marked Japan's first tariff concessions on colour film and paper, as well as additional concessions on black and white film and paper.

6.566 The **United States** argues that at the time the United States negotiated the 1979 Tokyo Round concessions on photographic film and paper, the three elements of Japan's liberalization countermeasures had all, to one degree or another, been put into place and applied. In entering into the Tokyo Round negotiations, the United States was aware that Japan regulated large stores through the Large Stores Law and promotions and inducements through the Premiums Law and the Antimonopoly Law.

6.567 However, according to the United States, what negotiators could not have known, and did not know, was: (i) the extent to which Japan's closed distribution system for photographic film and paper was the result of the government's "distribution countermeasures"; (ii) that the distribution countermeasures, the Large Stores Law and the promotion countermeasures worked together to impede market access. The United States emphasizes that during the Tokyo Round negotiations, neither the United States nor any other GATT contracting party could have anticipated the actions Japan would take (iii) to dramatically expand the scope and invasiveness of the Large Stores Law following the Tokyo Round; (iv) to escalate by a substantial degree the enforcement of the Premiums Law and the Antimonopoly Law to the photographic film and paper sector to undermine Japan's tariff concessions, specifically for the purpose of consolidating and strengthening the exclusionary distribution system against new threats from commercial challengers such as large stores. In this context, the United States points out that the panel on *EC - Oilseeds* specifically rejected the EC's argument in that case that the existence of some measures at the time of the tariff concession - which were later substantially enhanced - meant that the United States could or should have reasonably anticipated their modification or enhancement.[995] Moreover, the United States maintains that no country was in a position to conduct the kind of investigation that would have been required to understand that Japan had utilized a broad array of informal, nontransparent measures to engineer virtually import-free distribution channels and was continuing to apply a variety of measures to maintain those channels.

6.568 In **Japan's** view, the United States should have reasonably anticipated alleged measures in effect at the time of the tariff concessions: The Large Scale Retail Store Law and the Premiums Law were published laws with published regulations and their requirements were public facts; Likewise, all of the so-called "distribution countermeasures," which are not even included in the US non-violation claim concerning the Tokyo Round tariff concessions, were public facts, as were their alleged effects on the distribution structure for film and paper.[996] Thus, Japan concludes that no significant government measures or policy changes occurred after 1979. According to Japan, there were procedural changes in one pre-existing law, and industry self-regulation actions under the general authority of another pre-existing law. In Japan's view, there was thus no measure, unanticipated at the time of the 1979 tariff concessions, that was capable of upsetting the competitive position of imported film or paper. Even assuming that expectations concerning 1979 tariff concessions remain protected as a separate benefit, Japan asserts that the US non-violation claims relating to those concessions are unfounded.

(i) Distribution "countermeasures"

6.569 The **United States** submits that by the late 1970's, importers like Agfa and Kodak were denied access to primary wholesale channels due to wholesalers' exclusive relationships with domestic manufacturers. What the United States claims not to have been able to know was the extent to which

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[995]*See, e.g., EEC - Oilseeds*, p. 129, para. 149.

[996]All Fujifilm primary wholesalers were single-brand distributors by 1975; all Konica primary wholesalers were single-brand wholesalers at their inception, and subsidiaries by 1977.

concerted government policy had caused this exclusion and obstructed alternative channels, and the degree to which ongoing application of government measures continued to support this distribution system as an exclusionary system. According to the United States, following the Tokyo Round, Japan developed (i) 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 (ii) informational ties between manufacturers and wholesalers; and continued to rely upon (iii) Chambers of Commerce in ongoing application of standard transaction terms. Moreover, the United States argues that it could not have anticipated the effects of (iv) the international contract notification provisions which required reporting of all contracts between foreign manufacturers and Japanese distributors. Further, the United States argues that it could not expect that departures from standardized transaction terms could be (v) "unfair trade practices" under the Antimonopoly Law.

6.570 In **Japan's** view, by the time of the conclusion of the Tokyo Round, virtually all of the alleged distribution measures in dispute had already occurred. Japan argues that the historical measures and actions discussed by the United States are thus legally irrelevant to a proper analysis of the 1979 tariff concessions, i.e., the first concessions for colour film and paper, because they occurred *before* the 1979. The "Distribution Systemization Manual" was issued in March 1975, more than four years before the conclusion of the Tokyo Round. The JDB loan was made in 1976 and the SMEA financing came in 1967.[997] The last multibrand primary wholesaler, Asanuma, stopped carrying Kodak in 1975, again four years before the conclusion of the Tokyo Round. Therefore, for Japan it is clear that the United States could reasonably anticipate the alleged measures that already existed and the market structure as it existed at the end of 1975, when the tariff concessions were finalized in 1979 during the Tokyo Round.

6.571 In Japan's view, the United States does not even allege any so-called "distribution countermeasures" subsequent to the Tokyo Round, although these alleged distribution measures are the centrepiece of the US non-violation claims.

(ii) Restrictions on large stores

6.572 With respect to restrictions on large stores, the **United States** alleges that, as the Tokyo Round concluded, Japan tightened the enforcement of the Large Stores Law and related measures to block new challenges to the closed distribution system. The United States claims that Japan built on these substantial new restrictions by:

(1) creating the "prior adjustment" and "formal adjustment" processes (1979);[998]
(2) adding the "prior explanation" requirement to precede the builder's Article 3 Notification, i.e., requiring the builder to meet with and obtain the consent of local retailers before submitting the Article 3 Notification (1982);[999] and
(3) mandating that the adjustment process "be carried out in a restrictive manner" (1982).[1000]

6.573 The United States submits that Diet amendments to the Large Stores Law that became effective in May 1979 vastly expanded the coverage and impact of the law in two key respects. First, the law, which had previously applied only to stores with 1,500 square meters and above, was broadened to include stores with 500 square meters or more, causing store applications under the law to explode,

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[997]Japan notes that the United States indicated that the SMEA financing was granted in 1977. However, Japan claims that SMEA financing for photofinishing laboratories was first authorized in April 1967 and that even US documents mention such financing in the late 1960s.

[998]MITI Directive No. 365 of 1979, US Ex. 79-2.

[999]MITI Directive No. 36 on "Immediate Measures Regarding Notification to Establish Large Scale Retail Stores", 30 January 1982, US Ex. 82-2.

[1000]Ibid.

increasing by 300 percent in 1979. Second, large stores under the law were divided into Class I stores (1,500 and above), which fell under direct MITI jurisdiction, and Class II stores (500 to 1,500) which were placed under the regulation of prefectural governors. The United States explains that this division substantially increased the personnel and other resources available to investigate and order adjustments to stores. In the US view, as a consequence, Class II store applications, which reached 1,029 in 1979, fell to 424 in 1980 and to 308 in 1981, as implementation suppressed these stores.

6.574 **Japan** argues that by the time of the conclusion of the Tokyo Round, virtually all of the alleged measures in dispute regulating large stores had already occurred. According to Japan, only the following alleged measure regulating large stores occurred *subsequent* to the July 1979 tariff concessions, i.e., MITI administrative guidance on "prior explanation" and treatment of new notifications under the Large Scale Retail Store Law (1982).

6.575 In Japan's view, other historical measures and actions discussed by the United States are thus legally irrelevant to a proper analysis of the 1979 tariff concessions. All other alleged measures in dispute, as enumerated below, regulating large stores occurred *before* the 1979 tariff concessions, and therefore should have been reasonably anticipated by the United States at the time those concessions were made:

(i) the Large Scale Retail Store Law of 1973;
(ii) the amendments of the Large Scale Retail Law of 1978.

6.576 According to Japan, the United States argues that the 1978 amendments occurred after the 1979 tariff concessions. Specifically, in Japan's view, the United States seems to argue that substantive negotiations between the United States and Japan on film were concluded by August 1978, and that this date should serve as the time of the concessions. For Japan, the United States position in this case has no support in prior non-violation cases since tariff concessions have uniformly been timed by the date of the final act of the negotiating round in question, e.g., 11 July 1979 for the Tokyo Round.[1001] Japan notes that the 1978 amendments were endorsed by the Cabinet on 6 June 1978, approved by the Diet on 20 October 1978, and officially promulgated on 15 November 1978. Japan maintains that the United States knew or should have known about these amendments while the Tokyo Round was ongoing. Japan points out that the United States could have reopened negotiations on film or any other product allegedly impacted by the amendments. Japan emphasizes that the Cabinet action took place almost three months before the USTR letter to Kodak announcing film tariff concessions on 30 August 1978. Accordingly, Japan contends that any alleged upsetting of competitive conditions as a result of the 1978 amendments should reasonably have been anticipated by the United States.

6.577 In Japan's view, data submitted by the United States shows that from 1982 notifications of both categories of large scale stores consistently increase in number and that, accordingly, the 1982 administrative guidance had no material effect on the preexisting operation of the law. Japan describes that there was a decline from peak levels during the 1979 to 1981 period, but whatever caused that decline could logically have nothing to do with a measure passed in 1982. Similarly, after 1982, both the percentage of retail sales in Japan through large scale stores and the percentage of retail establishments that are large scale stores have increased steadily and consistently.[1002] Therefore, Japan concludes that, by any of these empirical benchmarks, the 1982 amendments did not represent a material change in the law.[1003]

[1001]See e.g., *EEC - Canned Fruits*, L/5778, p. 6, Table 2, para 14.

[1002]Japan contends that, although the numbers increased, the United States calls these trends "constant". But whether one views the trends as increasing or constant, Japan considers as the relevant legal conclusion that the 1982 amendments were not a material change in the law.

[1003]According to Japan, the United States acknowledges that this guidance was repealed in 1992 and is thus no longer in effect.

6.578 The **United States** submits that Japan complemented these restrictions under the Large Stores Law with new constraints on the ability of medium and large retailers to merge and expand: i.e., new constraints on potential direct challenges to the exclusionary distribution system.[1004] The JFTC then codified the restrictive policy reflected in its blocking order in new Retail Merger Guidelines which, according to the United States, were specifically directed at the retail sector in order to limit opportunities for larger retailers to avoid the tightening restrictions of the Large Stores Law through pursuing acquisitions, rather than by having to open or expand stores.

6.579 **Japan** responds that the United States' argument on the difficulty of mergers between large-scale retailers -- due to the review rule to consider the market share of large-scale stores alone -- is misguided. Even if such mergers become easier, the total area of floor space will not increase, therefore, there is no link between the merger regulations and the large-scale store regulations.

6.580 Japan further submits that the measures in question - which, according to Japan, have been abolished - were predictable "outgrowths" of preexisting policies. The 1982 MITI administrative guidance on "prior explanation" during the Large Scale Retail Store Law process introduced a mere procedural change to the law, requiring prior explanation of the new store plan.[1005] The basic operation of the law, i.e., regulation of large stores to preserve diversity of retailers, remained unchanged. Japan contends that the United States should have reasonably anticipated that the law would be subject to such procedural modifications that did not affect its underlying substance. In Japan's view, there was nothing unexpected about the 1982 guidance.[1006]

6.581 Japan further emphasizes that the current Large Scale Retail Store Law is an extension of the respective law of 1979, and actually more liberal than the one in 1979. Accordingly, Japan contends that, even if it were accepted that restrictions on large retail stores are unfavourable to imported products, there is nothing unfavourable to the imports which the United States could not have reasonably anticipated at the time of the tariff concessions in the Tokyo Round. Japan argues that this deregulation can be seen by comparing the past law with the present law with respect to the (i) exemption of retail stores with retail space less than 1,000 square meters, (ii) regulations on store holidays, and (iii) regulations on closing time.

(iii) Promotion "countermeasures"

6.582 With respect to the Premiums Law, the **United States** submits that Japan's negotiating partners could not have anticipated that Japan would respond to the Tokyo Round tariff cuts by engaging in elaborate and aggressive efforts to thwart foreign firms' ability to market and promote imports in the photomaterials and other sectors. According to the United States, within a year of the conclusion of the Tokyo Round:

[1004]The United States notes that in 1981, the JFTC blocked a proposed merger between a leading supermarket chain, Kyushu Daiei and a large local supermarket in Kyushu by the name of Uneed.

[1005]Japan further notes that the 1982 guidance also refers to potential large stores exercising "self restraint". To the extent this guidance simply suggested that stores themselves think about how their plans would affect the surrounding community, this guidance had no real impact on the operation of the law. In Japan's view, the United States jumps to the conclusion that this guidance was a "freeze". Pursuant to the guidance, prefectural governments might designate municipalities as those in which self-restraint on new notifications should be advised, provided the municipalities met with the specified requirements. In Japan's understanding, just a fraction of municipalities were designated as such.

[1006]Japan points out that the United States itself notes that earlier notification policies had already been adopted in May 1979, two months prior to the end of the Tokyo Round.

(i) the JFTC pressed for the creation of an umbrella group, the Federation of Fair Trade Councils, to coordinate the activities of the fair trade councils overseeing the 52 fair competition codes for representations and the 30 codes for premiums;[1007]
(ii) the JFTC approved the establishment of a Distribution Sector Office ("DSO") and directed it to examine 16 business sectors, including cameras and photographic materials;[1008]
(iii) the domestic photographic industry responded to JFTC guidance in promulgating its first set of "Self-Regulating Measures Regarding Making Business Dealings With Trading Partners Fair" in June 1982;
(iv) the formal establishment of the Promotion Council and its broad articles of association followed in December 1982;
(v) the Promotion Council's actions - together with the Zenren and JFTC - to derail Kodak's marketing campaign for the VR pack occurred in June 1982;
(vi) the Promotion Council published its second set of self-regulating measures in 1984;
(vii) the JFTC's efforts in this regard culminated in the creation of the Retailers Fair Competition Code and Fair Competition Council in 1987, to set and enforce standards for misrepresentations in advertising related to price/promotional terms.

6.583 **Japan** contends that, by the time of the conclusion of the Tokyo Round, virtually all of the alleged promotion measures in dispute had already occurred. According to Japan, only the following alleged promotion measures in dispute occurred *subsequent* to the July 1979 tariff concessions:[1009]

(i) Fair Trade Promotion Council self-regulatory code on dispatched employees (1982);
(ii) Fair Trade Promotion Council statement on photofinishing price representations (1984);
(iii) Camera Retailers' Fair Competition Code on advertising (1987).

6.584 In Japan's view, other historical measures and actions discussed by the United States are thus legally irrelevant to a proper analysis of the 1979 tariff concessions. All other alleged promotion measures in dispute occurred before the 1979 tariff concessions, and therefore should have been reasonably anticipated by the United States at the time those concessions were made.

6.585 With regard to the Camera Retailers' Fair Competition Code, Japan insists that it is irrelevant to this case because it relates only to cameras. Moreover, in Japan's view, the JFTC approval of the Code in 1987 was an application of the pre-existing Premiums Law, and brought about no change to the implementation policy of the Law.

6.586 As to the Fair Trade Promotion Council actions on dispatched employees and photofinishing price representations, Japan responds that such actions are irrelevant here since they are private conduct. Therefore, Japan contends that there is no government measure which the United States could not have anticipated.

[1007]The Fair Competition Code System and Status of Establishing Fair Competition Codes, Kosei Torihiki, No. 390, April 1983, pp. 37-38, US Ex. 83-8.

[1008]Cabinet Order No. 43 of 1979 as reported in JFTC Annual Report 1980, p. 283, US Ex. 79-1.

[1009]The United States mentions the 1979 establishment of the Distribution Sector Office in the JFTC. This action, however, led only to sector-specific advisory reports, not any governmental action.

(d) Uruguay Round

6.587 According to the **United States**, by the time of the Uruguay Round negotiations, the United States and other countries were beginning to understand that conditions in Japan other than tariffs that posed obstacles to imported products and that Japan's distribution system was difficult in general.[1010] The United States concedes that, at the time of the conclusion of the Uruguay Round, it was aware that Japan regulated large stores through the Large Stores Law and promotions and inducements through the Premiums Law and the Antimonopoly Law. But the United States could not have known, and did not know, how the three types of countermeasures worked together within the context of Japan's closed distribution system for photographic film and paper, nor what its restrictive effects were. The United States explains that even at the time of the Uruguay Round it still did not have (and could not have had) sufficient appreciation for the way government policies interwove and supported this closed distribution system in the film sector.

6.588 The United States submits that it was only with the preparation for consultations in this case that the United States gained an understanding of

(i) how the standardized transaction terms worked;
(ii) how the Large Stores Law continues to suppress large stores through non-transparent mechanisms as well as formal procedures;
(iii) how the suppression of large stores directly supports the oligopolistic distribution system in Japan's photosensitive materials sector;
(iv) how the restrictions on promotions directly limit opportunities for foreign film and paper;
(v) how subsidization of the laboratories takes them out of reach of foreign suppliers;
(vi) how Japan's active development of information links further enhanced systemization of distribution to the exclusion of foreign imports.

6.589 **Japan** contends that the issues now raised by the United States were not just discussed in reports, they have also been the subject of intense bilateral discussions between the United States and Japan. According to Japan, in the late 1980s and early 1990s, many of these issues were extensively discussed and debated between the United States and Japan as part of the Structural Dialogue (1986-1988) and the Structural Impediments Initiative (1989-1990).[1011] Therefore, Japan contests the US claim that the alleged measures are not of the kind that trade negotiators should reasonably be expected to understand, since the kind of allegations before this Panel are precisely the kind that US trade negotiators have emphasized for years in their dealings with Japan. In light of this history, Japan objects to the US argument that it could not have reasonably anticipated the alleged measures in dispute as of 1994. For Japan, it is obvious that the United States did know during the Uruguay Round about (i) single-brand distribution, (ii) the Large Stores Law, and (iii) restrictions under the Premiums Law, and had already formulated the allegations concerning them which that it has presented to this Panel.

6.590 The **United States** rejects Japan's argument that the United States could have anticipated that these measures would diminish the value of Japan's Uruguay Round tariff concessions. The United States maintains that bilateral discussions between the United States and Japan during the Uruguay Round in the late 1980s and early 1990s under the Structural Impediments Initiative do not demonstrate that the United States could have "anticipated" or understood Japan's program of measures at issue

[1010]1990 National Trade Estimates Report on Foreign Trade Barriers (NTE), p. 124, Japan Ex. E-4.

[1011]Summary Report on US-Japan Structural Dialogue (Japan Ex. E-5) and SII Final Report. (Japan Ex. B-30) By contrast, on these occasions, the United States even endorsed some of the measures the Japanese Government took. For example, the Report said, "obviously, [the Premiums law including Fair Competition Codes] is not intended to be an impediment to new entry by foreign or domestic firms, and the Fair Trade Commission (FTC) has enforced and will continue to enforce this system so that it does not impede such entry". SII Final Report.

in this case: According to the United States, none of the actual *measures* at issue was discussed in relation to its effect on the photographic film and paper sector because the focus of these bilateral discussions was on *private* obstacles to trade.[1012] The United States further emphasizes that it did not have any idea at the time, and only recently became aware of, the Japanese Government's direct responsibility for these measures, and the collective impact of these measures on the development and maintenance of Japan's exclusionary market structure for film and photographic paper.

6.591 Specifically, the United States submits that none of the 21 measures it has identified was subject to bilateral discussions with Japan in the late 1980s or early 1990s, with the exception of the following:

(1) The JFTC's restrictions on the use of premiums, including its restrictions on
   (i) premiums to wholesalers contained in JFTC Notification 17;
   (ii) premiums to consumers contained in JFTC Notification 5; and
   (iii) prize offers in open lotteries contained in JFTC Notification 34.
(2) The JFTC's notification requirements for international contracts, including those contained in JFTC Rule 1 concerning "Rules on Filing Notification of International Agreements on Contracts".
(3) The Large Stores Law.

(i) Distribution "countermeasures"

6.592 The United States took at face value Japan's commitments in the SII to address these private sector obstacles and liberalize its restrictive distribution structure. For example, in 1993, during the closing months of the Uruguay Round negotiations, the United States acknowledged "new commitments by the Government of Japan contained in the Second Annual Report of SII … in the areas of distribution and exclusionary business practices".[1013]

6.593 The United States confirms that the JFTC's notification requirements for international contracts, including those contained in JFTC Rule 1 concerning "Rules on Filing Notification of International Agreements on Contracts" were discussed with Japan in the context of the SII. However, the United States contends that it was completely unaware of the role the international contract notification requirements played in obstructing access to distribution channels in Japan by authorizing the Japanese Government to scrutinize transaction terms between foreign manufacturers and domestic distributors in line with Japan's guidance on standardizing transaction terms.

6.594 In **Japan's** view, the United States should have known and did know as of 1994 about all of the alleged measures currently in dispute. As to distribution policies, all of the alleged "distribution countermeasure" documents were published.[1014] Many official MITI publications, which are precisely the "sources that governments typically use to announce trade policies".[1015] In Japan's view, the alleged effects of MITI's distribution modernization policies, i.e., the decisions by the primary wholesalers not to carry other brands of film, were publicly known facts.[1016] In particular, according to Japan, the

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[1012]See, e.g., Ibid.. See also 1994 National Trade Estimates Report on Foreign Trade Barriers (NTE): "In short, exclusionary and particularly collusive business practices often prevent new participants, be they Japanese or foreign firms, from easily entering the Japanese market and competing for market share", 1994 NTE p. 145, Japan Ex. E-4.

[1013]1993 National Trade Estimates Report on Foreign Trade Barriers, p. 146, Japan Ex. E-4.

[1014]Japan notes that the United States was able to obtain copies of all of these items from public sources. The only exception is the 1975 Manual, drafted by a public corporation, but never officially published.

[1015]Japan points out that, e.g., the various interim reports and the 1970 Guidelines cited by the United States were all published in the MITI Gazette (the "Tsusansho Koho").

[1016]According to Japan, the United States argues that it did not know and could not have known "the extent to which Japan's closed distribution system for photographic film and paper was the result of the government's 'distribution countermeasures.'" Japan agrees in the sense that the connection between MITI's distribution modernization policies and single-brand wholesale distribution of film was unknowable because it was nonexistent. In Japan's view, since 1975, the

United States complains about the alleged "distribution countermeasures" in this proceeding on the ground that they encouraged single-brand distribution of film and paper. In this context, Japan notes that the United States has regularly complained about single brand distribution in National Trade Estimates Report on Foreign Trade Barriers ("NTE Reports") published by the Office of the United States Trade Representative. In the 1990 Report, the section entitled "Distribution System" contains the following passage:

> "The complexity and rigidity of Japan's distribution system raises the costs of new market entry and limits market penetration of US firms. … Exclusive relationships among retailers, wholesalers, and manufacturers, and large numbers of small wholesalers and retailers make setting up a distribution system expensive for new-to-market companies. This added cost of entry affects both US manufacturers of consumer and producer goods".[1017]

6.595 Japan emphasizes that the 1994 NTE Report[1018] even included the a film-specific passage in the section entitled "Distribution:"

> "Japan's distribution system can also serve to limit the market share of companies that have gained access to Japan's market. A leading U.S. producer of *consumer film*, for example, has encountered problems in increasing its market share in Japan due to restrictive distribution channels. Despite significant investment and years of effort, the company's market share remains extremely low compared to its market share in the rest of the world".[1019]

(ii) Restrictions on large stores

6.596 The **United States** claims that, at the time of the 1994 Uruguay Round tariff negotiations, it was not aware, and not able to be aware, that Japan had seized upon the Large Stores Law as a key instrument to protect and support the vertical integration of distribution in the consumer photographic materials sector. Furthermore, in the US view, it could not have been aware of the extent to which supporting vertical integration of distribution was in fact affirmative Japanese Government policy.

6.597 With respect to the Large Stores Law, **Japan** points out that the law and relevant regulations have been published and that their requirements are currently known and have long been publicly known facts.[1020] Moreover, Japan contends that the United States has been making these claims concerning the Large Stores Law with respect to imports generally for years. Thus Japan concludes that the United States not only should have known, it certainly did know about these measures.

6.598 Japan refers to the example of the 1990 NTE Report's chapter on Japan which includes the following specific headings: "Law on Large Retail Stores," and "Marketing Practice Restrictions". The section on "Law on Large Retail Stores" contains the following statement:

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only alleged "distribution countermeasure" is continued acquiescence by the Japanese Government in single-brand wholesale distribution. This alleged "measure" was a publicly known fact that should have been known and was indeed known by US trade negotiators before 1994. If an alleged "measure" consists simply of a market structure, and that market structure was known at the time of the tariff concession and has not changed since, there can be no frustration of legitimate expectations and hence no nullification or impairment of the benefit of the relevant tariff concessions.

[1017]1990 National Trade Estimates Report on Foreign Trade Barriers, p. 124, Japan Ex. E-4.

[1018]The 1994 National Trade Estimates Report of Foreign Trade Barriers was published on 31 March 1994, before the Uruguay Round Agreement was concluded, and was obviously written even earlier.

[1019]1994 National Trade Estimates Report on Foreign Trade Barriers, p. 172-173, Japan Ex. E-4 (emphasis added).

[1020]The Large Scale Retail Store law was published in Kampo on 1 October 1973. The Premiums Law was published in Kampo in 1962.

> "Although export losses due to this law's impact cannot be quantified, they are believed to be significant as a large number of products are affected. Since larger retailers are usually more willing to risk introducing new products, often directly imported from overseas suppliers, or aggressively promote imported product lines, limits on retail expansion effectively hinder the import of US goods".[1021]

6.599 According to Japan, the US concedes that the Large Scale Retail Store Law and several key elements of its claim about the Premiums Law were subject to specific bilateral discussions in the late 1980s and that its awareness and expectations concerning a specific law should apply to all products. Given that the law treats film no differently than it treats other products, in Japan's view, it is not credible for the United States to assert that while it was aware of how the law applied generally, it was not aware of how the law applied to film. For Japan, the US argument would make it virtually impossible to identify "reasonable expectations" for specific products and would undermine this element of the non-violation remedy.

6.600 With respect to the talks under the Structural Impediments Initiative, the **United States** argues that it took at face value Japan's assurances to liberalize restrictive distribution structures, and to substantially liberalize the Large Stores Law as one of the central means for doing so.[1022] According to the United States, Japan specifically indicated with respect to the Large Retails Stores Law that it would:

(i) shorten the coordination process for opening stores;
(ii) relax regulations on closing times and holidays;
(iii) address separate regulations by local public authorities;
(iv) exempt from coordination procedures after notification the new opening or expansion of new space dedicated to import sales;
(v) further review the Large Stores Law every two years.

6.601 The United States admits that Japan did in fact implement formal changes to operating hours and the coordination process for opening new stores and expanding space dedicated to imports, as stated in the SII report. The United States also concedes that Japan took action to address separate local regulations. Therefore, the United States was initially optimistic that these changes would be effective in increasing competition in Japan's distribution sector which is also reflected in the 1993 National Trade Estimates Report published by the USTR.[1023]

6.602 However, the United States submits that by 1994, subsequent to the conclusion of the Uruguay Round, it became clear that the limited reforms of the Large Retail Stores Law and other areas of business practice and government regulation put in place by Japan had not fundamentally changed the

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[1021]1990 National Trade Estimate Report on Foreign Trade Barriers, p. 124, Japan Ex. E-4.

[1022]In the 1990 SII report, for example, Japan stated that with regard to the Large Stores Law:

"As dynamic changes are called for in the distribution industry, deregulation measures will be taken in order to meet new needs of consumers, to enhance the vitality of the distribution industry and to ensure smooth procedures for opening new stores. Deregulation measures will be put in place by both the central Government and local public authorities".

[1023]The 1993 National Trade Estimates Report noted that "the distribution system is one of the six major areas being addressed in SII. The Joint Report issued in June 1990, contains a series of Japanese Government commitments addressing important distribution system issues. One of the most important was a pledge to ease significantly restrictions on new large-scale retail stores, including the further shortening of the new store application waiting period to twelve months by the end of 1991. The revision of the Large Retail Store Law in 1990 has largely been effective in reducing barriers to the establishment of retail outlets". Japan Ex. E-4.

restrictive nature of the law or the local regulations. The USTR's 1994 National Trade Estimates report reflects this growing disappointment.[1024]

6.603 The United States maintains that despite its commitment to "dynamic changes" to deregulate the Large Stores Law and to open distribution systems, Japan has continued to aggressively apply the law in a way that limits the ability of large stores to open and expand in Japan, stores as small as 500 square meters, as compared to 1500 square meters when the law was implemented in 1974. The delays, downward adjustments in floor space, reduced hours of operations, forced holidays, and burdens of the adjustment process significantly impair the ability of large stores to expand and operate at the pace and levels they would choose in the absence of regulation. The United States further submits that it did not expect Japan would continue to require or encourage large stores to undertake "prior consultation" or "local consultation" with their local competitors, and would continue allowing the voice of local competitors to dominate the large store review process.[1025] This process of undertaking adjustments with local competitors is particularly burdensome for large stores, as often large stores must agree to burdensome restrictions in order to ensure smooth passage through the formal review system.

6.604 **Japan** responds that the Large Stores Law today is more liberal than its operation in 1994. Three sets of deregulation of the law during the early 90's were completed by 1994, and there have been no significant changes since then. Any effort by the Japanese Government to ensure that local governments more faithfully adhere to the national standards for administering this law in fact makes the law more liberal, not less.

(iii) Promotion "countermeasures"

6.605 The **United States** claims that only recently it became aware of the extent to which the Japanese Government and the fair trade councils use the Premiums Law and the fair competition codes to limit how foreign photographic materials manufacturers and their distributors may promote their products. Likewise, the United States submits that it became aware only recently of the actions by the fair trade councils in the photographic sector to discipline both members and non-members in order to limit competition by new entrants on the basis of price or promotional offers.

6.606 With respect to the promotion measures, **Japan** states that the Premiums Law and pertinent notifications were published and their requirements are currently, and have long been, publicly known facts.[1026] All JFTC notifications and fair competition codes are also published, and are therefore publicly known facts.[1027] Japan underscores that the United States should be charged with knowledge of these published documents and publicly known facts. It further submits that the 1990 NTE Report's section on "Marketing Practice Restrictions" attacks the Premiums Law and even refers specifically to film:

> "Japan Fair Trade Commission (JFTC) regulations significantly restrict the use of premiums and other sales incentives offered to consumers, distributors and retailers. Under Japan's "Premiums Act" of 1962, the JFTC may authorize the establishment

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[1024]The 1994 National Trade Estimates Report noted that "In revising the Large Scale Retail Store Law, MITI rejected suggestions that the law be abolished, a move MITI maintained could have the effect of increasing local government regulations on large stores. The United States believes that MITI, at a minimum, should take steps to further streamline the Large Scale Retail Store Law, for example by reducing the current review period from 12 months to 3 months". USTR, 1994 National Trade Estimates Report, Japan Ex. E-4.

[1025]According to the United States, the fact that local competitors continue to dominate the large store review process is documented by Japanese Government studies.

Japan, however, points out that this US assertion relies on several translation errors of the cited documents, as described in sub-section V.C.2.(b).(ii) on "Substantive provisions of the Premiums Law" above, in particular paras. 5.400-5.402.

[1026]The Large Scale Retail Store law was published in Kampo on 1 October 1973. The Premiums Law was published in Kampo in 1962.

[1027]The US submission provides copies of all the JFTC notifications from readily available sources.

> of Fair Competition Codes. … Under this scheme domestic manufacturers establish industry promotion rules that are then accorded legal status by the JFTC. These rules impair foreign firms' ability to compete in the Japanese market. … Eliminating further restrictions could increase sales of many products. … it could also increase market opportunities for goods like film and candy, which are used as premiums".[1028]

Thus, Japan concludes that in 1990 the United States was making exactly the same arguments that it has made to this Panel. Japan further mentions that much of the language quoted above was then repeated, virtually verbatim, in the 1991, 1992, 1993, and 1994 reports.[1029]

6.607 With respect to the Premiums Law, the **United States** submits that the United States and Japan discussed in the context of the SII the JFTC's restrictions on the use of premiums, including its restrictions on

(i) premiums to wholesalers contained in JFTC Notification 17;
(ii) premiums to consumers contained in JFTC Notification 5; and
(iii) prize offers in open lotteries contained in JFTC Notification 34.

6.608 However, the United States emphasizes that, while these items were discussed as a *general* matter, the law was not discussed in its relation to the photographic materials sector. The United States further contends that the specific codes at issue in this case, specifically the Retailers Fair Competition Code, were never discussed. Moreover, to the extent that the Premiums Law and the fair competition codes were discussed generally during SII, the United States believed that Japan would follow through on its commitments in the SII Report "to enforce this system so that it does not impede new entry" by foreign or domestic firms.

[1028]1990 National Trade Estimate Report on Foreign Trade Barriers, p. 125, Japan Ex. E-4.

[1029]Japan Ex. E-4 provides the relevant excerpts from each of these National Trade Estimates Reports on Foreign Trade Barriers.

F. THE COMBINED EFFECT OF THE THREE SETS OF MEASURES

6.609 *Distribution countermeasures:* In the view of the **United States**, the "distribution countermeasures" work together as an organic whole. The individual specific studies, reports, surveys, guidelines, financing programs, or other distribution countermeasures standing alone may not have been sufficient to accomplish Japan's goal of restructuring the distribution system. According to the United States, MITI explained that the process of establishing a new industrial order would require back-and-forth interaction between government and industry over time. MITI expected government and industry to work together to set the targets for industrial restructuring, and for businesses to make efforts to achieve the targets, supported by government fiscal and other incentives. Leading scholars in Japan agree that one way that administrative guidance is made effective is by a continuing process of studying, surveying, cajoling, and targeting the use of fiscal incentives that keeps the private sector focused on the goals set by the government, assesses their achievement of those goals, and builds peer pressure on those who are falling behind in their achievement.

6.610 The US claim is that the measures listed in the "distribution countermeasures" section operate as a set, i.e. the distribution countermeasures as a set (i) violate Article III:4 and (ii) nullify or impair benefits under the GATT within the meaning of Article XXIII:1(b).

6.611 *Distribution countermeasures in combination with the Large Stores Law:* The United States alleges that the Large Stores Law and related measures have operated to support the vertically aligned distribution system fostered by the Government of Japan in the photographic film and paper sector. A 1971 MITI survey and report regarding transaction terms demonstrates that MITI viewed large stores as a threat to Fuji and Konica's oligopolistic distribution systems. It cites as two threats to this oligopolistic system the "growth of retail routes (especially regular chains and supermarkets) other than the photo retail route and changes in transaction terms due to this leadership", and secondly the "effects of full participation of Eastman Kodak". The guidance explained why large stores threatened oligopolistic distribution: "When this share [the share of film sales by supermarkets] becomes larger, influence over manufacturers will grow, and the market system controlled by manufacturers will be shaken". Without the measures to restrict the growth of large stores, the United States contends that large stores would have brought sufficient bargaining power and competition into the Japanese distribution system to erode the exclusive vertical control over distribution exercised by Japanese manufacturers. Therefore, the United States takes the position that the Large Stores Law and related measures should be considered as important measures in Japan's overall efforts to create and support manufacturer-dominated, vertically aligned distribution in Japan.

6.612 Therefore, the US claim is 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).

6.613 **Japan** contends that the United States merely takes a statement out of context to support its argument that the Large Scale Retail Store Law has "operated to support" the distribution system allegedly fostered by the government in the photographic film and paper sector.[1030] Japan argues that innocuous comments about "future problems" are a discussion about the threat of the reintroduction of irrational business terms, not the possible threat of large stores to some supposed oligopolistic distribution system that the government was allegedly trying to protect. Japan points out that it viewed

[1030]Specifically, Japan notes that the United States selects a few sentences from the residual category "other" at the end of a several hundred page report on transaction terms. Japan's 1969 Survey, p. 309, Japan Ex. B-1.

"free competition" as a positive development.[1031] The fear expressed regarding the increase in sales by supermarkets was not over the threat to some established domestic oligopoly, but rather a fear that these new retail channels would introduce irrational business practices, such as abnormally long payment periods, product returns, and dispatched employee practices.[1032]

6.614 *Restrictions on large stores:* The **United States** claims that independently of the role that the Large Stores Law plays in supporting the oligopolistic distribution system in the Japanese photographic film and paper sector, the restrictions on large stores have limited market access by curtailing an alternative channel to market foreign products. Even if unrestricted growth in large stores did not alter the exclusive manufacturer domination over Japanese wholesalers, it still would allow expansion of a sales channel that has proven to be more friendly to imports in Japan. The United States presents as an example that Agfa makes at least half its film sales in Japan to the Daiei supermarket chain, Japan's largest retailer. If Daiei's growth had not been retarded for three decades by repressive Japanese government regulation, it might be an even larger chain today and Agfa's sales to it would be greater. On the other hand, if Japan's primary wholesalers were not in exclusive relationships with Japanese manufacturers and were willing to carry foreign film, the need to rely on large stores as an alternative would be much reduced.

6.615 Thus, in addition to the position stated above regarding the Large Stores Law in combination with the distribution countermeasures, the US claim is 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).

6.616 In response, **Japan** first emphasizes that the Large Stores Law does not regulate which products large retailers can carry nor does it take into account what products, much less the origin of the products, that a retailer sells when determining whether and what adjustments are necessary. Second, Japan rebuts the alleged import friendliness of large stores by arguing that 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 particular products. In Japan's view, there is in fact no correlation between a store's size and its likelihood of carrying foreign brands; Agfa's success with Daiei, alleged by the United States, may have resulted from Agfa's concentration of its business effort on Daiei, and thus, has no logical connection to the large retail space of some of Daiei's stores (in addition to large stores, Daiei operates a number of small and medium-sized stores). Third, Japan points out that on its own terms, the law regulates large stores without regard to what relationship they and nearby small and medium-sized retailers have with any manufacturer or distributor; the law was designed to preserve a diversity of retailing outlets, a policy pursued by many national and local governments around the world. Accordingly, Japan concludes that the Large Stores Law cannot be upsetting the competitive position of imported photographic film and paper.

6.617 *Promotion countermeasures:* The **United States** alleges that the promotion countermeasures also have supported the closed, manufacturer-dominated distribution system. Most directly, Notification 17 under the Premiums Law took away an important means for foreign manufacturers to offer Japanese distributors a more attractive deal to handle foreign products. Notification 17 essentially ruled out all manners of premiums from manufacturers to wholesalers, except those of token value. Limiting the ability to offer premiums restricted the ability of foreign manufacturers to use their financial and marketing strengths to entice Japanese distributors from their exclusive relationships with Japanese

[1031]Japan points out that the United States left out a key portion of the quote: "the market system controlled by manufacturers will be shaken, *thus leading to an environment of free competition*" (emphasis added). Japan also notes a translation error: at the end of this quote, Japan inadvertently left out the phrase "and this effect is desirable". Although it is unlikely that the initial quote would be viewed as identifying a threat, the corrected quote clearly indicates that "free competition" is "desirable".

[1032]1969 Survey, Japan Ex. B-1, p. 309.

manufacturers, or to solidify their relationships with Japanese distributors. Because Notification 17 directly supported the Japanese manufacturer dominated distribution system, it should be considered both as a distribution countermeasures and a promotion countermeasure. Other promotion countermeasures also helped to restrict market access for foreign photographic film and paper in Japan. When a foreign manufacturer has limited access to the distribution system, it is especially important that it be able to reach Japanese wholesalers, retailers and consumers with attractive premiums and promotions. Taken individually, any one of the limits on premiums and promotions might not have substantially impaired the ability of foreign firms to compete in Japan. But taken as a group, the promotion countermeasures did have a significant chilling effect, particularly in the context of the system of enforcement through the fair competition codes and fair trade councils. Accordingly, the United States claims that the promotion countermeasures should be considered as a set for the purposes of Article XXIII:1(b).

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

6.619 **Japan** rejects the 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 and the measures related to the Premiums Law are individually considered as a "set of measures", they do not in any way disadvantage imports because, in Japan's view, combining nothing with nothing still produces nothing.

6.620 *Promotion measures, distribution measures and restrictions on large stores:* The **United States** further claim 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 large stores measures to nullify or impair benefits under the GATT within the meaning of Article XXIII:1(b).

6.621 **Japan** contends that the US claims of the three categories of measures acting in combination with each other are factually and logically flawed. First, in Japan's view, the United States did not submit credible evidence that the measures were intended to and in fact acted in combination. Japan also alleges that the United States has not provided evidence that the Large Stores Law in any way sought to affect foreign product given that the law currently applies and has always applied uniformly to all entities seeking to provide retailing services. Similarly, Japan contends that the United States has not provided evidence of JFTC actions adversely affecting foreign products. According to Japan, the measures had very different policy objectives, and were not intended to work together.

6.622 Japan concludes that panels should review measures themselves, not the consequences or the actual trade impact of the measures[1033] given that there are a myriad of influences on marketplace results. When the United States asks the Panel to focus on the alleged interaction of individual measures, in Japan's view, it appears to assess this interaction by looking to marketplace results such as low import market share. Japan contends that the United States has not shown any explicit interaction of these

[1033]Panel Report on *Japan - Taxes on Alcoholic Beverages*, WT/DS8, 10, 11/AB/R, AB-1996-2, p. 16; Panel Report on *United States - Section 337 of Tariff Act of 1930*, adopted on 7 November 1989, 36S/345, 386-387, paras. 5.11-5.13; Panel Report on *United States - Taxes on Petroleum and Certain Imported Substances*, adopted on 17 June 1987, BISD 34S/136, 154-159, paras. 5.1.1-5.1.9. Japan concedes that these panel reports addressed this issue in the context of Article III, given the similarity of the elements to be examined, Japan deems the Article III precedents cited as useful guide in evaluating the US non-violation claims.

measures, but has no alternative but to rely implicitly on the marketplace results.[1034] Accordingly, Japan concludes that the United States is thus asking this Panel to do what panels have repeatedly declined to do in the past, i.e., to go beyond the terms of the measures themselves and assess the marketplace results. Japan strongly disagrees with this approach as a matter of WTO legal principle, noting that, however, were the Panel to consider market share figures relevant, it actually undermines the US claims. Japan recalls that virtually nothing happened after the 1979 Tokyo Round concessions, but that some government actions occurred after the 1967 Kennedy Round concessions on black and while film and paper. The level and growth of import market share for black and white film and paper, however, are completely inconsistent with any conceivable nullification or impairment.[1035]

[1034]In the 1996 NTE Report, USTR noted that in this case "liberalization countermeasures" were implemented between 1967 and 1984, but that "MITI's past protection of this sector continues to have a lingering effect today in the distribution structure for consumer photographic materials". In Japan's view, it is clear that the United States is complaining about alleged "lingering effects", not measures.

[1035]Specifically, the foreign market share for black and white film and paper grew as high as 41.4 percent (1985) and 54.0 percent (1989) respectively.