

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).

of the imported product concerned.⁷⁰⁶

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

- 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

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*:

"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*

6.257 Thus the United States stresses that panels should examine the design, architecture, and structure of the measures at issue⁷¹⁶ 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 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

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

⁷¹⁷In *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*

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**

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.

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

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).

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

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 it 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 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

⁷²⁹The *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.

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

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 TD Ontaoreinomes 0.1orei

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

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**

- unfavourable to imports; and
- (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.

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.

(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 countermeasures⁷³⁹ 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.

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

⁷⁴⁰1967 Cabinet Decision, p. 6. US Ex. 67-6.

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

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

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

⁷⁴⁴Ibid. p. 33.

⁷⁴⁵Ibid., p. 36.

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 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 Council⁷⁵¹ 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

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

⁷⁴⁷Ibid., 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.

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

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

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

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

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

⁷⁵³Ibid, p. 10.

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

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 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

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.

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

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.

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 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

(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 contracts⁷⁷⁶ 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.

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

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

- 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.

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;

⁷⁷⁹The 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.

⁷⁸⁰Japan 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.

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

- (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, 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

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.

⁷⁸³MITI, 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.

⁷⁸⁴Ibid.

⁷⁸⁵Japan Ex. B-31

⁷⁸⁶MITI 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

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
- (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.

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".

⁷⁸⁷The 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

(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

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

⁷⁹⁴The 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.

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

⁷⁹⁶Japan 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.

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

structure.⁷⁹⁸

(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 manufacturers 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

6.337

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

(i)

6.349 The United States emphasizes that Japan'

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 terms⁸⁰⁷ 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 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

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

⁸⁰⁷Japan Ex. B-1

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**

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*

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

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 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 sector⁸²² 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

⁸¹⁹Japan 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.

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 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

⁸²⁶Murakami 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.

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

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

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.

⁸²⁹As explained in a recent guide to becoming a MITI-certified "management consultant": "Individuals taking the examination s

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 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

⁸³¹Japan 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.

⁸³²A 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.

⁸³³1968 Sixth Interim Report, US Ex. 68-8 and US Ex. 14.

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 Report⁸³⁵ 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 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

⁸³⁴1969 Seventh Interim Report, p. 4. US Ex. 69-4.

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

⁸³⁶Ibid., p. 80-81, US Ex. 71-9.

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

⁸³⁸Establishment 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.

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

b. In 1986, to implement the "Vision," the Centre issued a report⁸⁴³ 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 Council⁸⁴⁵ 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

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.

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

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

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

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

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

⁸⁴⁷*Ibid.*

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 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 relation ICus whics p3,salede.UnmizTc 0.210.

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 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.

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.

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

⁸⁵³Foreign 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.

⁸⁵⁴The 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.

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

⁸⁵⁵According 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.

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 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

⁸⁵⁶The 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 as 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.

⁸⁵⁷According 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.

⁸⁵⁸In 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.

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 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

⁸⁵⁹The 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.

⁸⁶⁰Distribution 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

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

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

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

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

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

⁸⁶⁶1993-1994 International Photo Processing Industry Report, p. 7-2, Japan Ex. B-54.

⁸⁶⁷According 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.

⁸⁶⁸The 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.

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

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

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

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.

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

⁸⁷³WTO 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 activities⁸⁷⁹ in relation to "new systems concerning the distribution of products".⁸⁸⁰ The law authorizes a broad range of assistance to businesses

⁸⁷⁴Japan 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.

⁸⁷⁷Special Measures Law to Promote Business Reform for Specified Industrialists

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 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

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.

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;

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

⁸⁸⁵According 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.

⁸⁸⁶Frederick 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.

- (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.

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 Law⁸⁸⁷ 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

⁸⁸⁷The 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.

⁸⁸⁸MITI 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.

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

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

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

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 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

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

⁸⁹⁵Japan 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.

⁸⁹⁶Large 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.

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

⁸⁹⁸*Ibid.* p. 157, para. 5.1.

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

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.

(c) Causal connection

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 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

⁹⁰⁶Survey 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.

⁹⁰⁷A 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.

⁹⁰⁸In 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.

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 sales⁹⁰⁹ and that Japan has not submitted credible data to show that this logical correlation does not apply in the case of photographic film.⁹¹⁰ In fact, an analysis of the Japanese survey data submitted at the US request⁹¹¹ 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

⁹⁰⁹Data 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.

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

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

⁹¹²In 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.

⁹¹³The 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.

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 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

⁹¹⁴Institute 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.

⁹¹⁵What 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 "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.

⁹¹⁶In 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.

⁹¹⁷As 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.

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 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

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.

(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.

⁹²¹The 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.

- (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 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

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

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

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 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.

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

(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 Japan, the JFTC's history is pictured by the United States as that of a

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

⁹²⁶The 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.

⁹²⁸See, 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.

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

⁹³⁰1967 Cabinet Decision p. 4, US Ex. 67-6.

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

⁹³²The 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 ..".

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

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

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

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

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, two Chairmen 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

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 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'

(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.

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**

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

(i) Promotion Council

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

"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 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

⁹⁶¹According 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 tripods 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.

⁹⁶²Asai 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.

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 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.

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

E. REASONABLE ANTICIPATION

1. THE LEGAL TEST

6.512 The **United States**

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:

"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

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 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

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;
- 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.

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

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).

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

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

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

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

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.

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

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 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

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

⁹⁸⁶There 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.

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

⁹⁸⁸See 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.

the market.

6.550 The

- (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.

⁹⁹⁰According 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.

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 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

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.

(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

⁹⁹³Japan 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.

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

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 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

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.

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, 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).

⁹⁹⁷Japan 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.

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

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

¹⁰⁰⁰Ibid.

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

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:

- (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

¹⁰⁰⁵Japan 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.

¹⁰⁰⁶Japan 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.

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

(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

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 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**

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 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 Report¹⁰¹⁸ 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

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:

"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 Retail 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

¹⁰²⁰The Large Scale Retail Store law was published in Kampo on 1 October 1973. The Premiums Law was published in Kampo in 1962.

¹⁰²¹1990 National Trade Estimate Report on Foreign Trade Barriers, p. 124, Japan Ex. E-4.

¹⁰²²In 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".

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 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

¹⁰²³The 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.

¹⁰²⁴The 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.

¹⁰²⁵According 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.

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 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

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

¹⁰³⁰Specifically, 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.

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 "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.

¹⁰³¹Japan 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".

¹⁰³²1969 Survey, Japan Ex. B-1, p. 309.

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

consequences or the actual trade impact of the measures¹⁰³³ 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 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