DISCUSSION

This submission addresses Kodak's allegations that Fujifilm controls its primary distributors -- the tokuyakuten -- thus permitting Fujifilm to maintain its dominant position in the Japanese consumer photographic film and paper markets. Although the tokuyakuten are under no contractual obligation to act as single-brand distributors of Fuji brand film,[1] Kodak claims that Fujifilm exerts control indirectly -- through guarantee deposits, rebates, and membership in the Mitsui keiretsu. After placing these allegations in some context in Section A, we address each supposed element of control in Sections B, C, and D.

A. Kodak's Allegations Of Fujifilm Control Over The Tokuyakuten Suffer From Basic Analytic Flaws And Are Ultimately Irrelevant

Before addressing the supposed mechanisms of control that Kodak alleges, we would like to underscore one fundamental point: detailed questions about Fujifilm's alleged control over the tokuyakuten are irrelevant to the fundamental issues presented in this case. It is important to remember the context in which Kodak complains about Fujifilm's supposed control over the tokuyakuten. Kodak claims, without any evidentiary support, that the tokuyakuten are the essential channel to reach Japanese retail store shelves. Kodak then argues that Fujifilm squeezed Kodak out of relationships with these distributors, creating and maintaining a "distribution bottleneck" through its control of the tokuyakuten. Thus, control is only relevant because Fujifilm supposedly controls the distributors and thereby effectively throttles Kodak's efforts in Japan.

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[1] "Rewriting History" at 73.

In the first place, Kodak's lack of relationship with the tokuyakuten has nothing to do with Fujifilm's alleged control over them. Although Kodak claims to have lost access to the tokuyakuten due to some grand collusive scheme following Japan's market liberalization, two of the four tokuyakuten of which Kodak complains have not carried Kodak film since World War II.[2] In other words, Kodak never lost access to these distributors because it never had access to them. As to the other two, these companies stopped carrying Kodak 20 to 30 years ago upon their own initiative as part of an industry-wide trend -- initiated in part by Kodak and its partner Nagase -- to market products through single-brand distributors.[3] Kodak's assertion that Fujifilm gained control over the tokuyakuten and then excluded Kodak does not square with the actual timing of market developments.

More fundamentally, Fujifilm has provided overwhelming empirical evidence to show that Kodak's theory of a "distribution bottleneck" is simply untrue. In Fujifilm's December 21, 1995 submission to USTR on the distribution system, we demonstrated that the vast majority of the tokuyakuten's customers either already carry Kodak or have existing relationships with Kodak suppliers.[4] In other words, Kodak is already widely available throughout Japan. This simple empirical fact destroys the relevance of all of Kodak's allegations about Fujifilm's alleged

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[2] Id. at 72.

[3] Id. at 68-69. In 1960, Kodak chose to make Nagase its exclusive importer. In 1967, Nagase acquired Kuwada, formerly a Fujifilm distributor. In 1969, Kuwada terminated Fujifilm and became a wholly-owned, single-brand distributor of Kodak products for Nagase.

[4] Fujifilm's December 21, 1995 submission at 4-9. A survey of the customers of the tokuyakuten showed that 78 percent of them either already carry Kodak (62 percent) or have an existing relationship with a Kodak supplier (another 16 percent). When weighted by volume, the total is 87.3 percent (77.3 percent and 10 percent, respectively). In other words, stores representing 87.3 percent of tokuyakuten sales of Fuji brand film already carry Kodak film or have easy access to it.

control of the tokuyakuten. When Kodak is so widely available among the tokuyakuten customers, how can Fujifilm be said to control the alleged bottleneck? The fact is that Fujifilm's relationships with the tokuyakuten in no way stop Kodak Japan from supplying the vast majority of the tokuyakuten's customers. Kodak Japan can and does sell to these customers already.

This leads to a third reason why Kodak's allegations are irrelevant. The distributor with whom the tokuyakuten will compete for sales of Kodak film -- if they carried it -- is Kodak Japan. Because Kodak bought its distributor (formerly Nagase, now Kodak Japan),[5] Kodak Japan is now at the same level of trade as the tokuyakuten carrying Fuji brand film. Kodak headquarters has refused to sell directly to any wholesaler in Japan (including the tokuyakuten) to allow it to compete on equal terms with Kodak Japan.[6] Since Kodak Japan would control the price it charges to both the tokuyakuten and the tokuyakuten customers, it would be impossible for the tokuyakuten to compete effectively with Kodak Japan for sale to these customers. In contrast, Fujifilm does not sell directly to the tokuyakuten's customers and the tokuyakuten are not, therefore, required to compete with Fujifilm for business with these customers.[7] Therefore, regardless of whether Fujifilm controls the tokuyakuten, Kodak has

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5 "Privatizing Protection" at 6; "Rewriting History" at 179.

6 Indeed, as discussed in "Rewriting History," this is a major reason Asanuma and Misuzu decided to stop handling Kodak products. See "Rewriting History" at 8-10.

7 Although there are a few customers of the tokuyakuten that are not carrying Kodak and which do not have existing relationships with a Kodak supplier, it is difficult to see why the tokuyakuten would be interested in supplying Kodak film to these customers. The volume of their purchases is small, Kodak Japan itself has not been successful in selling to them, and it would be equally difficult for the tokuyakuten to sell to them. Furthermore, if the tokuyakuten were successful in obtaining these customers for Kodak film, what would prevent Kodak from offering these customers a more attractive price than could be offered by the tokuyakuten and capturing these customers after the tokuyakuten had spent time and money developing them? In

completely ignored a basic question: why would the tokuyakuten want to carry Kodak when they have to compete with Kodak's 70 percent-owned subsidiary?

Kodak's allegations of control are irrelevant for a fourth reason: the issue of control arises only because Fujifilm -- unlike Kodak in the United States, Japan, and other major markets -- does not own its distributors outright. Since the tokuyakuten are not Fujifilm subsidiaries, they are legally independent entities. To make its case, Kodak has therefore been forced to craft its tale of an elaborate web of indirect control mechanisms. The resulting allegations are dramatic and attention-grabbing, but USTR must consider whether they have merit or value given the issues at hand. Consider a simple question: what if Fujifilm bought the tokuyakuten and thereby constructed a Kodak-like distribution system? Fujifilm would thus have legal control, and could legally prevent the tokuyakuten from carrying Kodak. The allegations about guarantee deposits, rebates, and keiretsu relationships would then become completely irrelevant. Kodak would have no complaint at all with respect to the alleged "distribution bottleneck."

Yet consider the irony of the current situation: because Fujifilm has opted for a <u>less</u> restrictive relationship than absolute legal control, it is now being criticized. If Fujifilm, like Kodak, owned its distributors, no one could complain about Fujifilm's refusal to allow its own subsidiaries to carry a competing brand. But since Fujifilm does not own the tokuyakuten, and since the tokuyakuten could (but do not) carry Kodak brand film, Fujifilm is the target of criticism. Essentially, <u>Fujifilm is being criticized because its distributors leave open the possibility of carrying Kodak brand film</u>.

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short, it would make no business sense for the tokuyakuten to use their resources to try to develop these customers for Kodak.

Kodak's position in this case is just plain hypocritical given its own distribution structure. In Japan and virtually every other market in the world, Kodak either owns its major distributors or maintains exclusive distribution relationships. It took Kodak quite a while to do so, but even in the Japanese market Kodak eventually acquired its major wholesalers, duplicated the captive/exclusive distribution system used elsewhere around the world, and refused to sell directly to other existing distributors including the tokuyakuten. Kodak Japan would never dream of carrying Fuji brand film. Forced to compete with Kodak Japan, why would the tokuyakuten doing business with Fujifilm choose to carry Kodak brand film?

B. The Use of Guarantee Deposits Is A Normal Business Practice And Does Not <u>Represent A Mechanism Of Control</u>

Kodak claims that the cash security -- known as guarantee deposits -- which Fujifilm collects from the tokuyakuten is a mechanism of Fujifilm's alleged control over these distributors.[8] As explained below, however, those deposits are merely one form of security, no different from other forms of security used throughout the business community all over the world.

Fujifilm's distributors are not required to post any kind of security at all -- provided they pay in cash. Indeed, Fujifilm offers cash discounts to encourage cash payments. But if customers decide to take advantage of Fujifilm's credit, it is only appropriate that they in turn offer some security to protect Fujifilm (at least partially) from the risk of loss.

Guarantee deposits are a common form of security instrument in Japan: many companies in many different industries use them. Fujifilm uses them as one way to secure

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8 Kodak's November 6, 1995 submission at 47.

accounts receivable from its customers -- not only the tokuyakuten, but also customers of other Fujifilm products. These security instruments have no bearing on whether a distributor deals exclusively with Fujifilm. They are simply one form of credit security among various means of security (e.g., mortgages of real property) to cover a target percentage of accounts receivable. Practically, guarantee deposits are used by Fujifilm as a secondary security; that is, if other forms of security (mortgages or pledges) are not sufficient, cash security is requested.

The guarantee deposits are not provided at one time but rather are built up incrementally. The financial burden on those customers that fulfill their security requirements with guarantee deposits is therefore minimized and cannot serve to hamper the tokuyakuten's financial position. Furthermore, the tokuyakuten can, upon request, withdraw their guarantee deposits at any time on the condition that they substitute some other form of security. In fact, because of this substitutability, Fujifilm holds no cash deposits from one of the four main tokuyakuten.

1. The use of guarantee deposits is a common business practice in Japan

Fujifilm's deposit arrangements with the tokuyakuten are unremarkable. First, Fujifilm uses such arrangements in the sale of not only photographic film and paper but also products not involved in this investigation, including x-ray film, professional film, and microfilm -- markets which Kodak has specifically stated are free of market barriers.[9] Second, the deposit

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[9] Kodak Vice President Ira Wolf stated in an August 26, 1995 speech before the Foreign Correspondents Club of Japan that "In areas where we have market access, where there are no formal or informal barriers erected to us, such as motion picture and TV film, x-ray film, microfilm, and professional film, we've done well. There is no inherent bias against Kodak products, even when there is strong competition." We note that the President of Eastman Kodak Asia-Pacific Ltd., Robert Smith, recently repeated this argument. Japan Times (Feb. 25, 1996) at 20. Yet Kodak never explains why the use of deposits is not a problem for these other products. The only conclusion is that they do not have an exclusionary effect -- for any product.

arrangements used by Fujifilm are commonly used as a tool for security throughout Japanese business. Exhibit 1 contains pages from a Japanese business book entitled Tampo no Chishiki (Knowledge on Security for Credit) in which guarantee deposits are described as one of the typical means of security. Exhibit 2 provides a selection of companies that, according to reports filed with the Japanese Ministry of Finance, use deposits like those used by Fujifilm. As indicated in Exhibit 2, guarantee deposits at these companies account for from less than 1 percent to more than 10 percent of these companies' total assets. By comparison, Fujifilm's 2 percent is actually at the low end of the range.

From a common sense perspective, it should come as no surprise that when a customer purchases a large amount of product from a manufacturer, but does not pay cash upon delivery, the manufacturer might require some kind of security to cover at least a portion of the potential loss. Indeed, the absence of some kind of security would give the customer cash flow benefits to which it is arguably not entitled. From this perspective, there is no difference between cash as security versus property as security, the latter of which is often used in the United States.

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Other Fujifilm divisions that use security deposits are instant photo products, electronic imaging products, information system products, printing materials, magnetic recording products, and pictography products.

2. Guarantee deposits are not a burden on the tokuyakuten

Currently, each of the tokuyakuten has some form of security arrangement with Fujifilm besides cash. These other forms of security include real estate mortgages, bank deposit pledges, bank guarantees, and stock pledges. In the case of one of the four tokuyakuten, all of its security with Fujifilm is non-cash.

For those customers that supply cash as security, Fujifilm collects deposits of around one percent of the value of purchases by that customer. As discussed in Section C below, all or part of these deposits can take the form of semiannual rebates by Fujifilm to the tokuyakuten, which, instead of actually being sent to the tokuyakuten, are held by Fujifilm as security pursuant to the agreement of the parties.[10]

With the collection of these cash deposits and other forms of security, Fujifilm tries to maintain security equal to between 60 and 70 percent of the average accounts receivable from each tokuyakuten. The target of 60-70 percent is not strict; it does not appear in any agreement between Fujifilm and the tokuyakuten. If combined securities increase to above the 60-70 percent range, this often will result in the parties' agreeing to a refund of deposits. If combined securities fall below this level, Fujifilm does not always require additional deposits; rather, Fujifilm simply continues to collect around one percent on its sales to the customer. However, if a customer's combined securities fall below the 60-70 percent range, Fujifilm may resist agreeing to refund a portion of the guarantee deposits.

We note that it is in Fujifilm's interest to agree to a refund of deposits given the constant accrual of interest at above-market rates. Fujifilm pays interest on the deposits semiannually.

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[10] Relevant sample agreements regarding guarantee deposits have been provided to USTR confidentially.

The applicable interest rate is tied to and varies with the two-year bank deposit rate (known in Japan as the "two-year Super 300 Deposit Rate") according to Figure 1 below. The interest rate is therefore better than the rate Fujifilm's customers would receive if they placed their money in a savings account. Indeed, as shown in Figure 2, the interest rate Fujifilm uses has also always exceeded Japan's short term prime rate.

Of those tokuyakuten that provide security in the form of cash, each has received refunds from Fujifilm, as reflected in the decreases in deposit balances from one period to the next shown in Figure 3.[11] Indeed, as a result of such refunds, deposits held for two of the four tokuyakuten have decreased consistently over time, both nominally and in relation to the relevant accounts receivable balances.

Therefore, the security instruments Fujifilm uses are not intended to be and do not function as an instrument of control over Fujifilm's distribution system in Japan for film and paper. Given the low rate used to accrue deposits, the above-market interest rates paid on the deposits, and Fujifilm's liberal refund policy, Fujifilm's security deposit arrangements do not have the effect of draining the profits of the tokuyakuten. They are simply a method by which Fujifilm, like many other Japanese companies, secures at least a portion of its average accounts receivable.

As is evident from the differences in the amounts of guarantee deposits of each of the four tokuyakuten, these deposits are simply one of several choices the distributors have in doing business with Fujifilm. If they have sufficient working capital, they may choose to pay promptly and realize the cash discount offered by Fujifilm. If they choose to rely on the extended payment

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[11] Note that Figure 3 shows that one of the tokuyakuten ("TK #3") does not maintain any guarantee deposit balance with Fujifilm.

terms permitted by Fujifilm, they forgo the cash discount and must provide additional security for their accounts payable to Fujifilm. If this option is exercised, they can choose to secure their accounts payable either through guarantee deposits or by providing alternative security.

The mix between each tokuyakuten's use of cash discounts, guarantee deposits, and alternative forms of securing accounts payable will depend on the particular situation of each company. A company may choose to finance its account payables with its own working capital and to take advantage of the cash discount offered by Fujifilm for most of its purchases; a company may have substantial assets and decide to use those assets to secure its accounts payable; or, a company may decide that the best use of its resources is to participate in the guarantee deposit system. In most cases, it appears that a combination of these options is used by the companies, reflecting each company's particular financial and commercial situation. This reflects an arm's length seller-buyer relationship where the buyer is able to tailor the commercial relationship in a manner that best suits its interests. There is no explicit or implicit element of control.

In practice, as demonstrated in Figure 3 above, the deposits collected from the tokuyakuten over the last four years hardly demonstrate a control relationship between Fujifilm and its distributors. Deposits increased from 1991 to 1995 for one of the tokuyakuten, but only by an annual average representing 0.2 percent of its average annual sales. Deposits held for two of the tokuyakuten each actually decreased such that Fujifilm's refunds exceeded its collections over the four year period. Finally, the deposits for the fourth tokuyakuten have remained stable at <u>zero</u> because it does not use this form of security. If guarantee deposits <u>did</u> provide Fujifilm effective control over the tokuyakuten, one would expect the deposits to be mandatory and to increase over time. Figure 3 shows that this is not the case. Even when the deposits increased for one of the distributors, the increase was so small that it could not possibly provide Fujifilm a mechanism to exercise the control Kodak alleges.

1. Kodak's comparison of tokuyakuten profits to guarantee deposits is both <u>wrong and irrelevant</u>

In Figure 7 of its November 6, 1995 submission, Kodak presents a comparison of profits to deposits for each of the four main tokuyakuten.[1] The point of the comparison is to show that the deposits "dwarf" profits and thus constitute a mechanism for Fujifilm to control the tokuyakuten. One look at Kodak's data proves their inaccuracy: as discussed above, Fujifilm does not collect guarantee deposits from one of the tokuyakuten and therefore there is no "dwarfing" of profits by deposits for that company.

Notwithstanding the questionable credibility of Kodak's data (and therefore its source), the issue is whether the existence of deposits that exceed profits is a phenomenon that matters. If, as discussed above, the deposits represent only a <u>portion</u> of a customer's accounts payable, then the deposits' relationship to profits is <u>totally irrelevant</u>. The deposits, which are not made at one time but rather are accumulated by minimal increments over years, cover an outstanding liability and therefore are not in any way subtracted from profits.

Kodak's graph <u>looks</u> astounding, but it is both wrong and irrelevant. What is astounding is Kodak's reliance on uncorroborated press statements and its ignorance of basic accounting principles.

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[1] Kodak's November 6, 1995 submission at 48 (Figure 7).

B. Kodak Misunderstands And Distorts Fujifilm's Rebates To The Tokuyakuten

Kodak makes several allegations regarding Fujifilm's rebate programs, charging that these programs give Fujifilm effective control over the tokuyakuten.[2] Kodak's characterization of Fujifilm's rebates, however, comes from incomplete knowledge and outdated information. As the description below shows, there are no anticompetitive elements in Fujifilm's current rebate programs. The rebates do not allow Fujifilm to control the tokuyakuten.

Before turning to a brief description of the rebates, however, we note that Fujifilm's rebates are much less progressive and exclusionary than those used by Kodak here in the U.S. market as recently as December 1995. Although eliminated as of January 1 of this year, until that time Kodak provided its customers a 4 percent "VIP" rebate -- with one step from zero to 4 percent -- to customers that met Kodak's volume targets. Particularly troubling was Kodak's willingness to waive the purchase target and award the rebate amount anyway if the customer agreed to stop carrying Fuji brand film. None of Fujifilm's rebate programs contains any provision that even remotely resembles this explicit, targeted effort to exclude Fuji brand film at the retail level.

Obviously, detailed information about rebates is extremely sensitive business information and has therefore been provided confidentially to USTR.[3] Fujifilm has no objection to USTR's

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[2] "Privatizing Protection" at 95-99 and 154-160; Kodak's November 6, 1995 submission at 75-87.

[3] Kodak keeps complaining about the fact that Fujifilm will not make its rebate programs public. This complaint is disingenuous. We challenge Kodak to do the same. Indeed, it would appear that once Fujifilm shed light on Kodak's exclusionary VIP rebates, Kodak eliminated the program for fear of public scrutiny. We also note that Kodak's attorneys' complaint about not seeing a more complete explanation of the rebate programs is their own fault; they are the ones who refused an offer by Fujifilm counsel to share confidential information between counsel.

conducting a confidential verification to confirm our explanation of the current Fujifilm rebate system. If it decides to do so, however, we strongly urge USTR to undertake the same examination of Kodak's rebate system in the United States. We are confident that if USTR takes the time to examine Kodak's practices, it will view Fujifilm's practices in an entirely new light.

1. Fujifilm's rebate programs are unremarkable

In "Rewriting History," we provided a brief description of the Fujifilm rebates that existed at the time of that submission, as well as a few that had recently been eliminated. We offer below a brief public summary of the programs currently in effect.[4]

As of October 1995, Fujifilm now offers only two rebate programs to the tokuyakuten relating to the sale of color film. Neither of these programs does anything to hinder Kodak's access to the Japanese market. The first rebate program pays a semiannual flat rebate as a minimal percentage of the tokuyakuten's total purchase amount during the period. This rebate program relates to the guarantee deposits described above in Section B. For those tokuyakuten with guarantee deposits, they can request (and Fujifilm usually accepts) that Fujifilm hold some or all of the rebate amount as a cash security.

The second rebate program is a target volume rebate for the tokuyakuten. For each tokuyakuten, a semiannual sales volume target is set for each sales region depending on historical performance. In addition, minimal target rebate rates are set for each of the tokuyakuten's sales regions. The actual rate paid to the tokuyakuten then depends on fulfillment of the sales volume target. The spread between the minimum and maximum rates offered is only

[4] "Rewriting History" at 81-85. Since filing "Rewriting History," Fujifilm's rebate programs have changed slightly. We focus only on those programs currently in effect, since those are the programs relevant to this proceeding.

around 0.5 percentage points.[5] Rebate amounts for this program are determined by multiplying the relevant rate by Fujifilm's suggested wholesale price.

In addition to these rebate programs, Fujifilm offers a cash discount to the tokuyakuten. Fujifilm also makes promotional payments with respect to selected retailers on a negotiated basis to enable them to compete on price against other brands -- a business practice also used by Kodak Japan. Here again, none of these programs acts to exclude Kodak from customers in the Japanese market. Finally, contrary to Kodak's allegations, Fujifilm's rebates and other promotional payments are never based on the resale price charged by the customer. Accordingly, Fujifilm's rebate programs are also incapable of acting as an instrument of resale price maintenance.

2. Fujifilm's rebates do not exclude Kodak

Kodak claims in its November 6 submission that our rebuttal on the issue of rebates was inadequate. It appears that part of its complaint relates to the fact that we did not divulge enough specifics about Fujifilm's proprietary rebate programs. We think our recent confidential submission should clear up this problem. It is too bad that Kodak's attorneys have refused to agree to share confidential information between counsel in this investigation.

The only other major part of Kodak's rebate allegations is its bogus comparison of the rebates the tokutyakuten receive from Fujifilm to the profits of the tokuyakuten.[6] Kodak's entire

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[5] Kodak apparently misunderstood our explanation regarding the target volume rebate program discussed in "Rewriting History" at page 82. When we referred to "0.6 percent" in that explanation, we meant 0.6 percentage points between the high and the low volume target rebates available to the tokuyakuten. We hope the clarification here and in our confidential submission makes clear that Fujifilm's target volume rebates are anything but "remarkably progressive."

[6] Kodak's November 6, 1995 submission at 80-83.

analysis is based on the assumption of progressivity. Without progressivity, rebates are simply price decreases or discounts received at the end of a period and have nothing to do with profits.[7] Therefore, Kodak's arguments could only have relevance for Fujifilm's single target volume rebate program. Once an appropriate analysis of this rebate program is done, however, the baselessness of Kodak's argument becomes clear.

As Kodak itself says, "the fundamental issue regarding the use of distributor rebates is whether such rebates can be used to exert exclusionary influence over the distribution."[8] In other words, and more to the point, the question is whether Fujifilm's rebates to the tokuyakuten discourage them from buying and selling Kodak film. In this regard, Kodak claims that because the rebates[9] are large enough to transform the tokuyakuten from unprofitable to profitable companies, the rebates act as a mechanism of control over the tokuyakuten. But Kodak simply assumes that if the tokuyakuten carried Kodak film, these rebates would largely disappear and there would be no more profits. This assumption, as shown below, is simply wrong.

At the outset, it is important to realize that even for Fujifilm's one mildly progressive rebate, the progressive element is very small. Whether the customer meets the target or not the

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7 Kodak attacks our claim that "only rebates based on target volumes can have the exclusionary incentive about which Kodak complains." Kodak's November 6, 1995 submission at 85, citing "Rewriting History" at 82. Kodak goes on to say that there are other methods of exclusion through the use of rebates, such as providing a rebate conditioned on not carrying other brands. While Kodak is correct in the abstract, Fujifilm does not have these kinds of rebates. Indeed, to our knowledge, the only member of this industry that has ever employed such tactics is Kodak with its VIP rebate program.

8 Kodak's November 6, 1995 submission at 81.

9 Kodak believes the "non-operating deductions" category in the tokuyakuten financial statements capture rebates paid to the tokuyakuten. Kodak's November 6, 1995 submission at 80-83. Actually, according to the tokuyakuten, they follow the normal accounting practice in

vast majority of the rebate rate is paid anyway.[10] Thus, for each tokuyakuten, the maximum effect of selling Kodak film instead of Fuji brand film is the small difference between the minimum and maximum rates -- only around 0.5 percentage points, as discussed above.

Furthermore, given that tokuyakuten customers representing 77.3 percent of Fujifilm sales through the tokuyakuten already carry Kodak,[11] there is no reason to think that the tokuyakuten would sell less Fuji brand film -- and thus earn a slightly lower rebate rate -- if they began selling Kodak film as well. Because most of the tokuyakuten's customers are already multi-brand dealers, the tokuyakuten would not have to sell any less Fuji brand film in order to sell more Kodak to these customers. These retailers stock both Fuji brand and Kodak brand film based on their understanding of Japanese customer preferences; they carry what sells. The retail customer might divide its Kodak film purchases among the tokuyakuten and Kodak Japan, but this sharing would have no appreciable effect on Fuji brand sales. Hence, Kodak's profit-to-rebate comparison completely fails as to these customers.[12]

In addition, for those customers that have access to a Kodak supplier but have decided not to carry Kodak film -- 10 percent of the tokuyakuten's sales on a volume basis[13] -- Kodak's

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Japan and record rebates as an adjustment to cost of goods sold, not as non-operating deductions. The rebates thus function simply to lower the net cost of buying Fuji brand film.

[10] Details regarding rebates are of course confidential, but they have been disclosed to USTR.

[11] Fujifilm's December 21, 1995 submission at 5-6.

[12] Of course, Kodak brand film could win market share if it were more aggressively priced. But Kodak already has this option through Kodak Japan. Kodak could completely overcome any negligible effect of the Fujifilm rebate program with an adjustment to Kodak prices.

[13] Fujifilm's December 21, 1995 submission at 5-6.

arguments are also largely irrelevant. These customers already have access to Kodak suppliers and have decided for whatever reason not to carry Kodak brand film. There is no reason to believe a substantial portion of these customers would change their minds and choose to carry Kodak brand film simply because the tokuyakuten offered Kodak.

Finally, all that is left is the 12.7 percent of the tokuyakuten film sales volume that goes to customers that do not carry Kodak film and apparently do not have existing Kodak suppliers. The question is whether tokuyakuten sales of Kodak to these customers would result in fewer Fuji brand sales. There is no reason to think -- and Kodak certainly offers no evidence -- that a decision by the tokuyakuten to offer Kodak to these customers would cause a significant dropoff in Fuji brand sales and thereby -- because slightly lower rebate rates were earned -- reduce the tokuyakuten's profitability. The differential between minimum and maximum rebate rates is too small, and the effect of offering Kodak on the tokuyakuten's ability to meet their Fujifilm sales targets is too minimal, for Fujifilm's target volume rebate to have any exclusionary effect.

C. Fujifilm Is Not a Member Of The Mitsui "Keiretsu" In Any Meaningful Sense Of That Term And Its Relations With The Mitsui Group Offer No Mechanism For Control Of The Tokuyakuten

Kodak has made many allegations about Fujifilm's membership in the Mitsui keiretsu.[14] We responded to several of these allegations in "Rewriting History"[15] and respond to several others below.

1. Fujifilm's affiliation with the Mitsui group is very weak

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[14] "Privatizing Protection" at 35-37; Kodak's November, 1995 submission at 10-14 and 46-47.

[15] "Rewriting History" at 18 and 114-116.

In its November 6 submission, Kodak makes a big deal of Fujifilm's denial that it is a member of the Mitsui keiretsu. Kodak called our denial of such membership a "whopper" and claimed that our denial "could only have been made by a company holding the U.S. Government's knowledge of the Japanese economy in utter disregard."[16]

This is nonsense. Fujifilm's denial of membership in the Mitsui keiretsu reflects the economic reality that the Mitsui group exerts no control over Fujifilm business decisions. Kodak and Fujifilm have a difference in perspective as to the definition of the term keiretsu -- an unsurprising difference given that, in the words of one of Kodak's own sources, "there is confusion in the usage of the word 'keiretsu.'"[17]

Notwithstanding this admission, Kodak and its sources assert that <u>any</u> connection is sufficient to enroll Fujifilm in the Mitsui keiretsu.[18] Indeed, the criteria used by the sources Kodak cites essentially place every publicly traded company in one of the industrial groups. Fujifilm and most knowledgeable commentators do not take this approach.

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[16] Kodak's November 6, 1995 submission at 10.

[17] Dodwell Marketing Consultants, <u>Industrial Groupings in Japan: The Anatomy of the Keiretsu</u> (1994) (hereinafter "Dodwell Report") <u>reprinted in part in</u> Kodak's November 6, 1995 submission, Evidentiary Appendix at 720. This is further supported by the fact that none of Kodak's sources agree on how many companies are affiliates of each keiretsu <u>or</u> which keiretsu a particular company may be affiliated with. For instance, while Tomokazu Ohsano, in his work <u>Hitome de Wakaru Kigyo Keiretsu</u>, classifies Ishikawajima-Harima Heavy Industries, Denki Kagaku, Tomen, and Japan Energy all in the Mitsui keiretsu, another Kodak source, <u>Keiretsu no Kenkyu</u>, places each of these companies in different groups: the first two in the Daiichi group, the third in the Tokai group, and the fourth in the Kogin (IBJ) group. Classification of keiretsu membership is therefore, according to Kodak's own sources, far from an exact science.

[18] Kodak's November 6, 1995 submission at 10-11 (citing <u>Keiretsu no Kenkyu</u> and Dodwell's <u>Industrial Groupings in Japan</u>).

Consider, for example, Professor Michael Gerlach's discussion in Alliance Capitalism: The Social Organization of Japanese Business.[19] Professor Gerlach, a business professor at University of California - Berkeley, is a leading western scholar of keiretsu relationships.[20] After surveying various patterns of affiliation, he concludes that "affiliation is a matter of degree rather than a clear in-or-out decision."[21] Professor Gerlach discusses at length the differences between members of a keiretsu group's President's Council and more peripheral members of the group. Professor Gerlach offers the following explanation for why companies like Fujifilm have only weak, if any, affiliations with a keiretsu:

> Although gaining market access may drive producer-oriented firms into keiretsu, these same alliances may constrain other market opportunities. For this reason, firms that maintain a clearly dominant position in an industry may have less incentive to develop clear affiliations than those with more modest positions. By remaining independent, market-dominant firms are in a position to sell to companies in all groups, as well as to other independent firms. Each is treated on a more equal basis and the widest market can be served. These firms are furthermore less likely to seek the security and prestige associated with group affiliation, since these same features accrue already from their strong market-leadership position.[22]

If one looks to the range of elements that go into a keiretsu relationship, Fujifilm has only a very weak connection to the Mitsui group.

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[19] M. Gerlach, Alliance Capitalism: The Social Organization of Japanese Business (1992).

[20] We relied on Professor Gerlach's work in "Rewriting History," a citation that Kodak conveniently ignored. Kodak instead accused us of relying on a "secondary work written for popular audiences." Given Professor Gerlach's academic credentials, this is hardly the case.

[21] Gerlach at 198.

[22] Id. at 184-85.

This weak connection is actually supported by the sources cited by Kodak. Although the Dodwell Marketing Consultants report, Industrial Groupings in Japan ("Dodwell Report"), attempts to classify a wide range of Japanese corporations into the six major keiretsu groups, it also recognizes that some affiliations are much weaker than others. Indeed, the application of the criteria used in the Dodwell Report shows that Fujifilm has only a weak connection to the Mitsui group.[23] Fujifilm is not part of the Nimoku-kai (president's council) or the Getsuyo-kai (management's council) of the Mitsui group. Fujifilm has no borrowing from any Mitsui group institutions.

2. Shareholding by Mitsui group companies in Fujifilm does not establish keiretsu membership

The only real connection between Fujifilm and the Mitsui group is cross-shareholding, but this connection is not surprising. A wide range of financial institutions invest in Fujifilm shares; some are members of the Mitsui group, others are not. Indeed, the largest institutional shareholder in Fujifilm (Nippon Life Insurance) is not a member of the Mitsui group. Likewise, Fujifilm's investments in the Mitsui group (using Kodak's loose and overbroad definition of the term) are not significant when compared to Fujifilm's investments in companies belonging to other groups.[24]

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[23] The report ranks Fujifilm as a "**" Mitsui member, third on a scale of four measuring a company's "inclination" to a group. Dodwell Report at 36 and 75 (1992 edition). This subjective judgement, however, appears to be based largely on shareholding.

[24] For instance, while Kodak states that 23.68 percent of Fujifilm's investments are in Mitsui group companies, Fujifilm's holdings in Sanwa group companies are nearly the same -- if not higher, depending on what definition of keiretsu is used.

Cross-shareholding alone is a very misleading way to classify keiretsu groups. Consider a few examples. The largest shareholders in Itochu, holding 9.3 percent of its outstanding stock, are all members of the Sumitomo group. Yet Itochu is a member of the president's council of the Daiichi Kangyo ("Daiichi") group, members of which hold only 6.4 percent of Itochu shares.[25] Or consider Kodak's own business partner, Nagase Sangyo, which holds a 30 percent share of Kodak Japan. Sumitomo group companies have an 11.2 percent share of Nagase, much more than the 3.0 percent held by members of the Tokai group.[26] <u>But Nagase Sangyo is a member of the president's council of the Tokai group.</u>

Indeed, a cross shareholding analysis would place Fujifilm in <u>two</u> keiretsu groups (notwithstanding its lack of membership on <u>any</u> group's executive council). While Mitsui group companies hold 12.4 percent of Fujifilm stock, Sanwa group companies hold 8.9 percent.[27] Using the Dodwell Report methodology, the Mitsui group scores a "**" inclination rating, and the Sanwa group would score a "*" rating. With just a fraction more shareholding,[28] the Sanwa group would also score a "**" rating. If it really had any control over Fujifilm, why would the Mitsui group allow a rival group to maintain comparable shareholding levels?

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25 Japanese Ministry of Finance ("MOF") Report for Itochu (June 1995) (report under Article 24, paragraph 1 of the Securities and Exchange Law).

26 MOF Report for Nagase Sangyo (1995).

27 Exhibit 3 provides a list of the top ten Fujifilm shareholders and their group affiliates (if any). We also provide an excerpt from the 1995 Fujifilm MOF Report for which the list is derived.

28 If Sanwa held an additional 1.5 percent of stock, raising its holdings from 8.9 percent to 10.4 percent, it would cross Dodwell's threshold for a "**" inclination classification. With 10.4 percent shareholding, Sanwa would surpass the "30 percent of top ten shareholding" threshold used by Dodwell. Dodwell Report at 36 (1992 edition).

3. Fujifilm has no directors from the Mitsui group

As explained in "Rewriting History," no Mitsui group companies have ever had any personnel on Fujifilm's board of directors or in Fujifilm's management.[29] Kodak's claim that "[g]enerations of Fuji executives have been officers and directors of Mitsui group banks"[30] is just wrong.

In an attempt to prove its point, Kodak provided a list of six people who worked for Mitsui group companies and Fujifilm during the period 1959-1984.[31] Each of these people had already retired from management positions at their Mitsui group companies when they worked at Fujifilm. More importantly, however, each of the people on Kodak's list was an auditor at Fujifilm.[32] Auditors, by law, are required to maintain independence from the companies they audit.[33] Therefore, auditors cannot play dual roles as auditor and director or employee of the companies they audit. Indeed, Japanese law prohibits an auditor from becoming a director or even an employee of a company (or its subsidiary) which he is currently serving.[34] The fact that Fujifilm has received only auditors from Mitsui group companies (including Sakura Bank) thus

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29 "Rewriting History," Appendix at 4.

30 Kodak's November 6, 1995 submission at 10-11.

31 Id. at 12.

32 Kodak's characterization in Table A of its November 6 submission of Mr. Itakura as a director of Fujifilm is simply wrong.

33 Japanese Commercial Code § 276. The purpose of auditors is to ensure that directors are meeting their fiduciary duties to the corporation. Japanese Commercial Code § 274.

34 Commercial Code § 276.

underscores the conclusion that the Mitsui group exercises no control over Fujifilm's management and operation.

If Fujifilm wanted to be a part of the Mitsui keiretsu, and wished to strengthen its relationships with Mitsui financial institutions, nothing would prevent Fujifilm from accepting board members or even a president from Mitsui group companies. The fact that Fujifilm does not have anyone from Mitsui group companies on its board of directors again illustrates Fujifilm's independence from the Mitsui group.

Therefore, if one looks at the broad range of possible connections -- cross-shareholdings, president's council membership, financing, and personnel relations -- the connection between Fujifilm and the Mitsui group is about as weak as one could imagine.

4. Lending relationships between Mitsui banks and the tokuyakuten prove absolutely nothing

Kodak claims that lending relationships between a distributor and a manufacturer's keiretsu banks constitutes evidence of influence by the manufacturer.[35] Kodak claims that since Fujifilm is a member of the Mitsui keiretsu, any lending by Mitsui banks to the tokuyakuten represents a mechanism of control over the tokuyakuten by Fujifilm. Specifically, Kodak says that the borrowing of the tokuyakuten is closely correlated to the banks' share of ownership in Fujifilm and that financial analysts have reported that Mitsui banks have provided financing to one of the tokuyakuten (Misuzu) because of its status as a Fujifilm primary distributor.[36]

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[35] Kodak's November 6, 1995 submission at 46.

[36] Id. at 47 (citing a 1995 confidential credit report from a Japanese supplier).

As discussed above, Fujifilm's affiliation with the Mitsui group is limited at best, and is insufficient to classify the company as a member of that keiretsu in any meaningful sense. Furthermore, there is no connection between Mitsui group shareholding in Fujifilm and Mitsui group lending to the tokuyakuten. In any event, the question is whether Fujifilm's relationships with Mitsui banks -- however strong -- provide Fujifilm with a mechanism of control over the tokuyakuten. The answer to that question is an emphatic no.

First, the fact that the tokuyakuten borrow from Mitsui banks in itself is unremarkable. Sanwa, Daiichi, Fuji,[37] Sumitomo, Mitsubishi and Sakura are the six major bank groups in Japan, all of which compete for borrowers. These banks together dominate Japanese banking business. Indeed, in terms of assets, these institutions are among the very largest banks in the world. It is no surprise, therefore, that the tokuyakuten would seek financing from these as well as other banks.

Second, it is no surprise that Mitsui banks would want to finance a primary distributor of Fujifilm products -- not simply because of some keiretsu affiliation with Fujifilm, but because Fujifilm is one of the most respected and successful companies in Japan. The fact that the tokuyakuten buy and sell a large quantity of Fuji brand film would alone be enough to justify lending to one of the tokuyakuten. The existence of a keiretsu affiliation, if one existed, would be unnecessary. The tokuyakuten make independent business decisions about the banks from which they borrow.

Finally, Kodak's unsubstantiated claim that "the borrowing of the tokuyakuten is closely correlated to the bank's share of ownership in Fuji" is just wrong. Any coincidental relationship

[37] There is no relationship between Fuji Bank and Fujifilm.

between tokuyakuten borrowing and bank ownership in Fujifilm is irrelevant given the extent of borrowing by the tokuyakuten from other, non-Mitsui related financial institutions. Using Kodak's own data, Asanuma gets 39 percent of financing from Mitsui banks, but it obviously gets 61 percent from others; while Misuzu gets 29 percent of its financing from Mitsui banks, it obviously gets 71 percent elsewhere; while Kashimura gets 53 percent from Mitsui banks, 47 percent is from other banks; Ohmiya, finally, gets only 13 percent of its financing from Mitsui banks.[38] Therefore, even Kodak's numbers show a lack of dependence by the tokuyakuten on Mitsui bank financing.

Whether Kodak's numbers are right or not (we are uncertain of their origin), the tokuyakuten's own financial reports show that the top two lenders for each tokuyakuten include at least one and sometimes two banks from <u>outside</u> the Mitsui group. Consider Figure 4:

FIGURE 4

TOP TWO LENDING BANKS FOR FOUR MAIN TOKUYAKUTEN

Asanuma	Misuzu	Kashimura	Ohmiya
Daiichi (32.1 percent)	Sakura (35.1 percent)	Sakura (45.5 percent)	Sumitomo (36.9 percent)
Sakura (32.1 percent)	Daiichi (22.3 percent)	Fuji (19.2 percent)	Iyo (26.9 percent)

A clear pattern emerges: the tokuyakuten maintain balanced borrowing relationships with a variety of financial institutions. Only Kashimura can be said to rely predominantly on a Mitsui group bank. The others rely on non-Mitsui banks as much as anyone else. Indeed, Ohmiya borrows only a relatively small amount from Mitsui banks. These data rebut Kodak's allegations of dominating lending relationships.

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[38] "Privatizing Protection" at 35.

As Kodak itself claims, each of the tokuyakuten has different, non-Mitsui, main banks and they receive financing from several banks. They do not need Fujifilm to run interference for them to obtain financing. They can borrow on their own. The Mitsui keiretsu, even if Fujifilm were a member, is therefore irrelevant to Fujifilm's alleged control of the tokuyakuten.

CONCLUSION

Kodak acknowledges that Fujifilm has no direct control of the tokuyakuten: Fujifilm holds stock in only two of the four tokuyakuten and those shares are hardly large enough to constitute control. Kodak is therefore left with only allegations of indirect control through mechanisms such as guarantee deposits, rebates, and keiretsu relationships. With this submission, we demonstrate that Kodak's allegations are based on insufficient facts and faulty theories.

In any event, the important question is this: even if Kodak's allegations were accurate, would they matter? As we have also shown both here and in previous submissions, the answer to this question is no. Kodak film is widely available in most stores throughout Japan, particularly in the camera specialty stores that sell the most film in Japan. The problem is not Fujifilm; the problem is that Kodak has not done what is necessary to appeal to Japanese consumers.