

Annual Reform Recommendations from the Government of the United States to the Government of Japan under the U.S.-Japan Regulatory Reform and Competition Policy Initiative

October 14, 2001

Launched by President Bush and Prime Minister Koizumi on June 30, 2001 under the U.S.-Japan Economic Partnership for Growth (the Partnership), the Regulatory Reform and Competition Policy Initiative (the Regulatory Reform Initiative) is designed to further deregulate the economy, bolster competition, and open markets in Japan.

The United States is encouraged by Japan's continuing commitment to reform and the recent strong statements by Prime Minister Koizumi to "promptly and swiftly" carry out regulatory reform and to adhere to the principle of "No Growth Without Reform." The United States also welcomes establishment of the Three-Year Program for Promoting Regulatory Reform by the Cabinet on March 30, 2001, and the announcement of the Reform Work Schedule by the Koizumi Administration on September 21, 2001.

Consistent with the overall objective of the Partnership, the recommendations set out herein include reform measures pertaining to key sectors and cross-cutting areas expressly designed to facilitate a return to sustainable growth in Japan. Further, in an effort to create a new, constructive tone in the U.S.-Japan bilateral trade and economic relationship, the United States has made a concerted effort to focus on issues that Prime Minister Koizumi and his Administration have identified as important areas for reform, such as information technologies, telecommunications, medical, energy, and competition policy.

The proposals included in the Summary of Recommendations and the Annex are being provided to serve as the basis for discussions over the coming year in the High-level Officials Group and the Working Groups established under the Regulatory Reform Initiative. They are also being provided to serve as the basis for an annual report to the President and Prime Minister specifying the progress made under this Initiative, including reform measures to be taken by each Government.

An important feature of this Initiative, as described under the Partnership, is integration of the private sector into the work of the two Governments. The United States looks forward to working with Japan over the coming weeks to identify issues addressed in this Initiative that could benefit from private-sector input. Areas of interest to the United States include privacy issues related to information technologies, reduction of regulatory requirements for competitive telecommunications carriers, energy liberalization and supply security, and cross-border share exchanges.

The U.S. Government is pleased to present these reform recommendations to the Japanese Government and looks forward to receiving Japan's reform proposals to the United States.

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SUMMARY OF RECOMMENDATIONS

TELECOMMUNICATIONS

Japan has set an ambitious goal of building one of the world's most advanced telecommunications network infrastructures by the year 2005. Given the "multiplier effect" of this sector in stimulating growth, investment, and efficiency throughout the economy, this is a laudable goal. Attempting to achieve this goal while at the same time maintaining and deepening competition, however, poses formidable policy challenges, given the susceptibility of advanced services to monopolization.

With both the "eJapan Strategy" and the Koizumi Administration's regulatory reform initiatives, Japan has begun to implement policies that can significantly contribute to economic growth and increased investment through the development of a more vibrant information technology sector. Parts of the current Three-Year Program for Promoting Regulatory Reform – such as rationalizing regulatory methods, increasing transparency of procedures, and ensuring increased competition in the IT sector – are of particular importance to the telecommunications sector.

Recent telecommunications policy initiatives in Japan have aimed to put this sector on a pro-competitive footing. This process has brought about improvements in the telecommunications and information technology environment in Japan, but it is incomplete. While the current momentum for reform in these sectors is encouraging, the United States urges Japan to complete the process of instituting and implementing a pro-competitive regime, rather than settle for something less.

SUMMARY OF RECOMMENDATIONS

- **Deregulating Competitive Carriers:** Eliminate or reduce filing and reporting requirements for competitive carriers, especially for wholesale services.
- **Regulatory Independence:** Establish a strong, independent telecommunications regulatory authority and eliminate government ownership of service providers.
- **Dominant Carrier Regulation and Competition Safeguards:** Strengthen and implement dominant carrier regulations to prevent competitive abuses by Nippon Telegraph and Telephone (NTT) and NTT DoCoMo.
- **Interconnection:** Reduce high interconnection rates and reform the inefficient rate structure that hinders the development of a competitive telecom market.
- **Rights of Way and Access to Incumbent Facilities:** Further facilitate access to infrastructure that competitors require to reach subscribers.
- **Resale/Unbundling:** Expand the scope of services subject to resale obligations and provide transparency for setting wholesale discounts. Broaden access to NTT network elements for competitors, including certain computer systems and require NTT to provide to competitors access to emergency services, which NTT currently denies.
- **Universal Service:** Fully evaluate whether a universal service subsidy program is necessary and ensure that any proposed subsidies are competitively neutral.
- **International Internet Services Policy:** Analyze how growth of and access to Internet services can be furthered not through regulation of international links but through enhanced competition in domestic bottlenecks.

INFORMATION TECHNOLOGIES

Information technologies are revolutionizing the way business, government, education and entertainment are conducted. Despite the recent slowdown of IT-related industries and the shake-out among “dot.com” companies, e-commerce has become an established and key component of our economies. Both the United States and Japan recognize the need for continued development of this sector, which has tremendous growth potential that will ripple across the economy in numerous areas identified by the Koizumi Administration as reform priorities, such as health care and education. The United States looks forward to cooperating with Japan to create and promote a competitive and innovative IT sector which can benefit both economies and societies, as well as provide global leadership for the use of information technologies.

For the IT sector to thrive and flourish, a regulatory framework must be established that ensures competition, promotes innovation, allows private sector-led regulation, and protects intellectual property rights in the digital age. Through the “e-Japan Strategy,” as well as the subsequent “e-Japan Priority Policy Program” and “e-Japan 2002 Program,” Japan has recognized the importance of these principles in relation to its goal of becoming the “world’s most advanced IT nation” in five years. Japan has reaffirmed these principles as IT Sector Priority Items under the Three-Year Program for Promoting Regulatory Reform, and Prime Minister Koizumi recently stated in his policy speech to the Diet on September 27 that he is committed to accelerating IT reform. The United States welcomes these efforts and urges the Japanese Government to continue its dialogue with a diverse range of domestic and foreign parties to ensure flexibility and responsiveness to private sector needs and emerging technologies.

A primary focus on the IT sector under this Initiative is to establish a new framework that will promote the development of IT-related businesses and innovative information technologies that can be utilized to spur growth in other key sectors of the economy. The United States submits the following recommendations and proposals for working together to achieve this goal:

SUMMARY OF RECOMMENDATIONS

- **Legal Framework:** Establish and strengthen a legal framework in Japan that is appropriate for the digital age to ensure that use of the Internet and e-commerce can thrive.
 - **Privacy and Consumer Protection:** Ensure transparency in the implementation of any new privacy laws, and promote a high level of consumer confidence in doing business online through the development of private sector self-regulatory initiatives.
 - **E-commerce:** Ensure that laws governing electronic transactions are technology-neutral and that U.S. and Japanese approaches for payment systems via the Internet facilitate online transactions.
 - **E-government:** Further promote an IT-based interface among government, citizens, and business.
- PROPOSALS FOR COOPERATIVE EFFORTS:
- **E-education:** Work together on initiatives which complement e-Japan plans to expand PC-based Internet use throughout Japan’s education system.
 - **Private Sector Use of IT and E-commerce:** Jointly promote the use of IT and e-commerce for all companies regardless of their size.
 - **Network Security:** Coordinate on issues concerning international cooperation to protect the integrity of the Internet.

ENERGY

The U.S. Government welcomes the steps Japan already has taken toward liberalization of its electricity and gas sectors. Genuine competition in the energy sector would enable Japan to meet its goals of economic growth and increased efficiency by reducing electricity costs and encouraging innovation. A competitive environment would also help Japan diversify its primary energy supply by supporting the Japanese Government's planned increase in natural gas usage – thus promoting Japan's goal of maintaining energy supply stability. The steps Japan has taken to date, however, have proven insufficient to meet these goals. The United States urges the Japanese Government to take bolder steps to promote a competitive environment in both its wholesale and retail energy sectors, including fair, transparent and non-discriminatory access to electricity transmission and distribution lines as well as to gas terminals and pipelines.

The reforms the U.S. Government proposes for the Japanese electricity and gas sectors complement broader reforms already underway in Japan. By helping to lower electricity costs to internationally competitive levels and reduce costs for consumers and commercial users, liberalization of Japan's energy sector will contribute to one of Prime Minister Koizumi's key areas for reform – urban renewal. These reduced costs also stand to help Japan's industries to gain a greater degree of competitiveness.

To foster economic growth and stability of energy supply in the context of the current global uncertainties, the U.S. Government urges Japan to fully implement reforms that have already begun and promote further liberalization in the electricity and gas sectors as set out in the recommendations below.

SUMMARY OF RECOMMENDATIONS

- **Regulatory Process and Competition Policy:** Articulate concrete measures to promote regulatory authority independence, define policy goals for the energy sector reform process, improve competition policy safeguards, and expand access by all market participants to the policy-making process in this sector.
 - new entry and ensure that privatization and sale of any generating assets promote competition.
- **Electricity Access and Transparency:** Promote equal access to transmission and retail services, as well as greater information and accounting transparency, for all market participants.
- **Gas Access and Transparency:** Promote a competitive gas and LNG market through unbundling and transparency of usage charges and information.
- **New Construction:** Establish guidelines to determine the need for transmission construction and promote construction between electricity service areas.
- **New Construction of Transportation Infrastructure:** Establish guidelines to determine the need for pipeline and LNG facility construction and promote construction of pipelines between gas service areas and LNG facilities within electricity service areas.
- **New Entry of Competitive Generators:** Expand electricity infrastructure to promote
- **New Entry of Competitive Gas Suppliers:** Expand transmission infrastructure in the gas sector to guarantee new entry by gas suppliers and electricity suppliers.

MEDICAL DEVICES AND PHARMACEUTICALS

The U.S. Government generally welcomes Prime Minister Koizumi's focus on medical sector reform as Japan seeks "to achieve efficient, high quality medical care." Innovation, harmonization, transparency, predictability, and enhanced efficiency achieved through the introduction of market forces can help Japan meet these goals and spur economic growth. Faster approval and broader availability of innovative drugs and medical devices can dramatically reduce overall healthcare costs while improving the quality of care.

During the reform process, it is critical that innovative products are not falsely labeled as cost-drivers and targeted for inappropriate price cuts. Addressing systemic inefficiencies in Japan that drive high healthcare expenditures (including the longest average hospital stays in the world, over-capacity of hospitals, lack of IT systems and limited hospital specialization, etc.) and removing regulatory and trade barriers in this key sector can lead to the a more efficient allocation of resources and encourage the more rapid introduction of life-enhancing and cost-effective products to Japanese patients. This, not short-term expedients, is the key to true reform with long-lasting benefits for Japan. It is vital that all interested parties, including the U.S. medical device and pharmaceutical industries, have "meaningful opportunities" to participate in the reform debate and that their proposals are given "serious consideration."

SUMMARY OF RECOMMENDATIONS

- **Healthcare System Reform:** Introduce competitive market forces and pursue structural reform in order to improve Japan's, healthcare system, including increasing the level of medical information available to the public and expanding the roles of private companies in hospitals and nursing care facilities.
- **Medical Device and Pharmaceutical Pricing Reform:** Ensure that the introduction of innovative medical devices and pharmaceuticals is encouraged and receives timely and "appropriate valuations that recognize the role of the market." Assure that such products are not subject to arbitrary price control measures that devalue innovative products.
- **Medical Device and Pharmaceutical Regulatory Reform:** Continue to introduce steps to expedite regulatory approvals of medical devices and pharmaceuticals, particularly for products that are available in other major markets, but have not yet been introduced into Japan.
- **Acceptance of Foreign Clinical Data:** Continue to work within the International Council on Harmonization process to promote the broader use of foreign clinical data and facilitate more efficient utilization of Japan's clinical trial system.
- **Nutritional Supplement Liberalization:** Further deregulate the sale of nutritional supplements.

FINANCIAL SERVICES

The U.S. Government welcomes Japan's successful implementation of the measures under the 1995 U.S.-Japan Measures Regarding Financial Services, as well as Japan's actions taken to date under its Big Bang financial deregulation initiative. A more efficient and competitive financial sector will play a crucial role in returning Japan to its full growth potential. The introduction of private defined contribution pension plans this year is a particularly welcome step in encouraging income security, better corporate governance, and more flexible labor markets.

SUMMARY OF RECOMMENDATIONS

- **Defined Contribution Pensions:** Encourage the development and adoption of defined contribution pension plans by creating a clear and unified regulatory regime for the industry and by allowing plan providers to gain regulatory approval for prototype plans.
- **Investment Trusts:** Encourage greater household and pension fund investment in securities by increasing the safety, flexibility, and understandability of investment trusts and by lowering the costs of providing this key investment vehicle.
- **Self-Regulatory Associations:** Increase the transparency and openness of the operations and decision-making of industry associations that have a self-regulatory, investor protection, or other public policy roles.
- **Postal Financial Institutions (*Yucho* and *Kampo*):** Allow greater flexibility for the postal financial institutions to employ the services of investment advisory companies through direct onshore trust arrangements. Increase transparency and promote private sector provision of services by subjecting any new financial service activities proposed for the Postal Financial Institutions to full public comment and consideration before their introduction.
- **Financial Institution Reporting and Notification:** Work closely with the private financial services community to review and streamline current requirements for financial institution reporting. Allow financial institutions to maintain records in electronic form, and where possible, to distribute reports, filings and notifications by electronic means.

COMPETITION POLICY

The U.S. Government shares the Council for Regulatory Reforms' view that the vigorous promotion and preservation of competition in Japanese markets, including through the creation of a climate conducive to new entry, is essential to Japan's economic recovery. To meet these challenges, it is necessary that the Japanese Government ensure that the Japan Fair Trade Commission (JFTC) has the tools, resources, and administrative independence necessary to enforce the Antimonopoly Act (AMA) effectively and to promote competition throughout the Japanese economy.

This will require strengthening of the JFTC's structure and investigatory capabilities, as well as bolstering the effectiveness of its enforcement actions. It will also require a government-wide program to seriously address the bid rigging system or *dango*. Such a program, if successful, could reduce public-works outlays by 30 percent and free resources for employment-creating initiatives, which is in line with Prime Minister Koizumi's key priority of expanding the social safety net. Achievement of this goal will also require a Japanese Government commitment to rely on competition and market principles as it continues down the road of economic restructuring and regulatory reform. The United States, therefore, recommends that Japan take the measures set out below.

SUMMARY OF RECOMMENDATIONS

- **Independence and Staffing of the JFTC:** Change the JFTC's organizational status to ensure its independence, and substantially increase its staff and resources.
- **JFTC Investigatory Capabilities:** Institute a corporate leniency program for AMA violators, improve JFTC powers and procedures for criminal accusations, ensure severe punishment of those who impede JFTC investigations, and provide adequate staffing for AMA enforcement in the information technologies and public utility sectors.
- **Effectiveness of AMA Enforcement Actions:** Improve the deterrent effect of surcharge orders, extend the scope of elimination orders, and widen the scope of permissible private injunction suits.
- **Elimination of Bid Rigging:** Implement a series of measures to eliminate bid rigging, including the introduction of effective legislation to prevent *kansei dango* (bureaucrat-led bid rigging).
- **Competition and Regulatory Reform:** Prevent re-regulation by private sector restrictions (*min-min kisei*) or anticompetitive administrative guidance, promote competition in industries undergoing regulatory reform, and pursue privatization of public corporations in a manner that enhances competition.

TRANSPARENCY AND OTHER GOVERNMENT PRACTICES

The United States appreciates that the Japanese Government has made the need for greater transparency a crosscutting theme of its Three-Year Program for Promoting Regulatory Reform (Cabinet Decision of March 30, 2001). It is essential for a vibrant economy that its regulatory system ensure transparency, fairness, predictability, and accountability. It is important that domestic and foreign firms alike have full access to information and opportunities to participate in the regulatory process.

The systemic measures set out in the Three-Year Program could contribute to needed improvements in the transparency and accountability of the Japanese regulatory system. They include: the strict enforcement and promotion of the use of the Administrative Procedure Law; increased transparency of administrative guidance; full and effective implementation of the Law Concerning the Disclosure of Information Retained by Administrative Agencies; wide and effective use of the Public Comment Procedures for Formulating, Amending and Repealing Regulations; introduction of the “No Action Letter” system; comprehensive and objective evaluation of the regulatory process; and examination of the need, effects, and costs of new proposed regulations.

Building on these measures, the United States recommends that the Japanese Government undertake the following additional improvements in its regulatory system to support Japan’s reform efforts and ensure that all players have the same access to government information and the policymaking process.

SUMMARY OF RECOMMENDATIONS

- **Public Comment Procedures:** Revise the Procedures to make them an effective regulatory mechanism, including by establishing a central registry for all solicitations, requiring a minimum 30-day comment period, authorizing an independent review of use of the Procedures, and establishing a study group to examine the Procedures.
- **Administrative Guidance:** Reduce the use of administrative guidance and require all administrative guidance to be issued in writing (except in special cases).
- **Public Participation in Development of Legislation:** Develop a mechanism that would enable all interested domestic and foreign parties to review and comment on draft legislation before governmental agencies submit the draft legislation to the Diet.
- **Judicial Review of Administrative Actions:** Increase the authority of the courts to review administrative actions of governmental agencies.
- **Public Corporations:** Ensure that the process of restructuring and privatizing public corporations is transparent and private sector entities have an opportunity to provide input.
- **Regulatory Impact Analysis:** Introduce a Regulatory Impact Analysis (RIA) system that would apply to significant regulatory changes.
- **Postal Financial Institutions:** Ensure that the transfer of postal services to a public corporation is undertaken in a transparent manner; curb expansion of product offerings of postal financial institutions; and subject the postal financial institutions to the same standards of regulation as their private-sector counterparts.

LEGAL SYSTEM AND INFRASTRUCTURE

To facilitate Japan's recovery and economic restructuring, it is critical that Japan create a legal environment that is conducive to international business and investment and that supports regulatory and structural reform. The Japanese legal system must be able to respond to the market's needs for international legal services in Japan, as well as facilitate business transactions and provide for the expeditious resolution of disputes. To meet these challenges, Japan needs to undertake significant reform of its legal system so that it is easily accessible and can function expeditiously and efficiently.

The United States recognizes that Japan has begun the process of addressing a number of critical legal reform issues. The Judicial Reform Council (JRC) in its report (*Recommendations of the Judicial Reform Council – For a Judicial System to Support Japan in the 21st Century*) has made a number of significant recommendations for the improvement of the Japanese judicial system. It is now important for the Japanese Government to take decisive action to implement the JRC's recommendations – through the timely preparation and enactment of effective legislation. To this end, the United States recognizes that the Japanese Government has begun that process by establishing a Headquarters for Judicial System Reform and making judicial reform one of the priorities of its reform programs.

SUMMARY OF RECOMMENDATIONS

- **Unrestricted Freedom of Association:** Eliminate all prohibitions against freedom of association between Japanese and foreign lawyers and allow them to determine their own forms of association.
- **Restrictions on Foreign Lawyers:** Allow foreign lawyers to hire Japanese lawyers and to provide advice on third-country law on the same basis as Japanese lawyers; allow foreign lawyers to establish professional corporations, limited liability partnerships (LLPs), and limited liability corporations.
- **Improvements of Foreign Lawyers Regulatory System:** Ensure that foreign lawyers have opportunities to participate in the development and enforcement of rules that affect them; reduce the time required for foreign lawyer registration.
- **Implementation of Judicial Reform Council's Recommendations:** Expeditiously implement JRC's recommendations to increase the number of legal professionals, reform the Arbitration Law, increase the speed and efficiency of civil litigation, strengthen judicial oversight of agencies, and reduce filing fees for civil litigation in Japan.
- **Improvements in the Japanese Judicial System:** Take additional measures to improve the judicial system by improving evidence-gathering methods, augmenting protection of trade secrets during court hearings, clarifying the attorney-client privilege, making judicial remedies more effective, and increasing the transparency of judicial proceedings.

COMMERCIAL LAW

The United States commends Japan for undertaking a major initiative to reform its Commercial Code and other commercial laws. Comprehensive revision of Japan's commercial laws should have a profound effect on both domestic and foreign firms. The liberalization of restrictions on equity securities will facilitate the acquisition of capital necessary for restructuring and new investment. By introducing greater flexibility into the organization, management and capital structure of companies, particularly through improvements in corporate governance, corporate management will become both more accountable and efficient, which in turn will lead to increased productivity and competitiveness. Reform of Japan's commercial law also has significant implications for the ability of foreign firms to invest and operate effectively in the Japanese market, bringing crucial technologies, know-how and employment to Japan's economy. One key impediment to increased foreign investment in Japan is the inability of domestic and foreign companies to engage in cross-border share exchanges, which are permitted between purely domestic companies.

For these reasons, the United States encourages Japan to build on the Commercial Code recommendations of the Legislative Council by taking the following measures.

SUMMARY OF RECOMMENDATIONS

- **Cross-Border Share Exchanges:** Permit and promote cross-border share exchanges.
- **Flexibility in Capital Structure:** Permit cash mergers; revise in-kind contribution court supervision procedures; eliminate restrictions on the quantity and recipients of stock options, on the transferability of new subscription rights and on non-voting shares; and permit classes of shareholders to elect a specified portion of the board.
- **Corporate Governance.** Provide publicly traded companies the option of adopting an executive committee and outside director system instead of continuing to use the statutory auditor system; apply any mandatory outside director system only to publicly traded companies; ensure that outside directors are truly independent; oppose changes to the shareholder derivative system that undermine board accountability to shareholders; permit companies to use electronic means for required shareholder meeting procedures; reinforce the obligations of fiduciaries that manage pension funds; and ensure that financial statements accurately represent the financial condition of a company.
- **Statutory Agents.** Oppose any proposal to require foreign corporations to appoint statutory agents who would be jointly and severally liable for all liabilities of the corporation.
- **Public Input into Commercial Law Revision Process.** Provide the public, including the international business and legal communities, with meaningful opportunities to provide input into the formulation of recommended revisions to the Japanese Commercial Code and other commercial law.

DISTRIBUTION

Japan's Three-Year Program for Promoting Regulatory Reform states that "the distribution sector functions as a nexus connecting producers and consumers, and plays a major role in....improving the quality of life of the citizenry." The U.S. Government applauds the Three-Year Plan's goal to "advance regulatory reform of the distribution sector, including the abolition of regulations that impede free corporate activities, to contribute to improving consumer convenience and expanding consumer choice, and to facilitate upgrading and improving the efficiency of the distribution sector as well as the manifestation of ingenuity by distribution sector enterprises."

The ability to move goods quickly and inexpensively from producers to consumers is not only a key measure of economic efficiency, but also of vital importance to economies seeking to benefit from the information technology revolution. In its introduction to the new Simplified Declaration Procedures, the Ministry of Finance acknowledges this important point. The Ministry notes that "as the employment of information technology becomes increasingly advanced globally, distribution is becoming more expeditious" and there is consequently "a growing interest in further simplifying and speeding up customs procedures to facilitate trade."

The United States urges Japan to continue modernizing customs clearance procedures. The need for the rapid delivery of goods and information has produced a number of new industries that are now seen as vital for the smooth development of the global economy. One of these industries is the express carrier industry which has seen exponential growth in recent years and is now an essential tool for the conduct of international business and for the timely distribution of goods and information. The United States believes there is a need to modernize customs clearance procedures to take full advantage of the economic benefits provided by these new industries.

SUMMARY OF RECOMMENDATIONS

- **Simplified Declaration Procedures:** Adapt the regulations implementing the Simplified Declaration Procedures to make them widely available to integrators/agents handling air cargo.
- **De Minimis:** Raise the *de minimis* value in the Customs Clearance Law from 10,000 yen to 30,000 yen.
- **Nippon Automated Cargo Clearance System (NACCS):** Continue to consult with users of Air NACCS to ensure that an equitable fee structure is installed after the expiration of the current three-year arrangement.

ANNEX

TELECOMMUNICATIONS

- I. Deregulating Competitive Carriers.** Although Japan has taken significant steps to improve its regulation of dominant carriers, it has done little recently to relieve the regulatory burdens still imposed on competitive carriers – burdens generally regarded as among the heaviest among OECD economies. Japan's recent Three-Year Program for Promoting Regulatory Reform, however, focuses precisely on these kinds of issues (i.e. areas relating to rationality of regulation and IT promotion). To address these issues, which contribute significantly to the cost of doing business in Japan and act as a disincentive to investment, the United States recommends that for competitive carriers, the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) adopt the following measures:
- A. Institute a policy, and obtain any necessary legal authority from the Diet, to forbear from applying legacy regulations where competition in a market or market segment permits user interests to be achieved without government intervention; and where risks of competitive abuses are minimal;
 - B. For competitive market segments, institute class licenses, which do not require any application by providers, for both Type I and Type II services;
 - C. For services offered to the public generally, replace tariff filing requirements with Internet-based public notifications, eliminating any ex-ante MPHPT procedures;
 - D. For contract-based services, eliminate all filing and notification requirements;
 - E. For interconnection, entrustment, and other business arrangements between competitive carriers, eliminate all filing and notification requirements;
 - F. For initial licensing requirements, eliminate requirements to provide detailed cost justifications, financial assumptions, and network planning information beyond the general scope of services and description of network;
 - G. For network expansion, eliminate any approval processes, and limit any notification requirements to brief general descriptions;
 - H. For companies combining Type I and Type II operations, eliminate regulatory barriers preventing such carriers from operating seamlessly as integrated entities (i.e. able to provide customers Type I and Type II services as an integrated service offering); and
 - I. Permit carriers to operate both as Type I or Type II carriers using IRU's, including wavelength-based IRU's.

II. Regulatory Independence. Most OECD countries have recognized that an independent regulatory authority is the most effective means of providing a competitive framework for telecommunications services and expanding user benefits. By placing its regulatory authority for this sector within MPHPT, Japan has created an environment where the regulatory function can be unduly exposed to political interference. This problem is exacerbated by potential conflicts of interest associated with the fact that MPHPT pursues large-scale industrial policy programs, the implementation of which could have a significant competitive impact on this sector. While creation of the Telecommunications Business Dispute-Settlement Commission is a positive step, the United States is disappointed that creation of a truly independent regulator has been removed from consideration under the current regulatory reform agenda. In this light, the U.S. Government recommends that Japan implement the following measures to strengthen regulatory independence:

A. Independent Regulator

1. To minimize undue political involvement in regulatory decisions, which could compromise the impartiality of such decisions, initiate the full separation of the regulatory function from other MPHPT functions, including industrial promotion, as is done in other OECD countries;
2. Eliminate potential conflicts of interest between the government's role as owner and regulator of dominant carriers by introducing legislation to permit the full divestiture of government ownership in NTT companies, and eliminate all direct government involvement in the operational decisions of these companies; and
3. Limit potential personal conflicts of interest by strengthening safeguards related to private-sector secondments to MPHPT, and MPHPT facilitation of transition from public to private sector employment (*amakudari*).

B. Telecommunications Business Dispute-Settlement Commission

1. Empower the dispute-settlement commission with the authority and financial means to order substantive, independent audits of companies engaged in potentially infringing practices;
2. Empower the dispute-settlement commission with injunctive relief and authority to enforce decisions with monetary penalties;
3. Institute procedures (e.g. closed deliberations) to ensure that commission members are able to make decisions free of MPHPT and NTT influence; and
4. Require commission decisions and the rationale for such decisions to be made public.

- C. Other Measures: Institute procedures to facilitate parties' ability to appeal regulatory decisions.

III. Dominant Carrier Regulation and Competition Safeguards. The United States welcomed Japan's adoption of enhanced asymmetric regulation in its June 2001 amendments to the Telecommunications Law, which provided for clearer rules on carriers with a dominant position in its market and more specific obligations. The United States recommends that MPHPT vigorously implement and enforce such regulations, particularly in regard to:

- A. Unbundling advanced facilities, such as remote terminals and fiber optic cable;
- B. Non-discriminatory access to poles, ducts, conduits, and rights of way;
- C. Non-discriminatory access to Operations and Support Systems (OSS) for interconnection and access to unbundled network elements;
- D. Requirements for tariff filings and methods for evaluating pricing abuses by dominant suppliers (e.g. imputation tests);
- E. Guidelines to eliminate discriminatory pricing of origination services (e.g. *Telehodai*);
- F. Means to ensure that wireless termination rates are cost-based;
- G. Introduction of separate affiliation requirements to ensure that a dominant carrier does not abuse its position in the provision of value-added services (e.g. if NTT East or West were to enter the Internet services market);
- H. Accounting and reporting requirements (i.e. separate affiliate transaction rules) to ensure that a dominant supplier does not use revenues from a regulated service to subsidize a non-regulated service; and
- I. Competition-related performance metrics, including reporting requirements, and financial penalties for missing metrics. Such metrics should ensure that a dominant carrier treats competitors no less favorably than it treats itself or its affiliates in matters such as provisioning, quality of service, and repair and maintenance of all network services and facilities needed by competitors.

IV. Interconnection. In FY2001, the United States looks forward to Japan's putting in place amended ordinances on interconnection that implement rate reductions in a manner consistent with measures included in the Third Joint Status Report of the Enhanced Initiative on Deregulation and Competition Policy that:

- A. Ensure that NTT eliminates the interconnection surcharge applied to calls originating or terminating on ISDN lines;
- B. Eliminate non-traffic-sensitive costs from usage-based interconnection rates;
- C. Require the NTT regional companies to provide interconnection within six months of application or face financial penalties, and refrain from assessing “premium charges” unless there is a need for major network modification; and to require itemized charges for modification, subject to independent review;
- D. Ensure competing carriers the right to set retail rates for their subscribers for calls terminating on DoCoMo’s network; and
- E. Require NTT regional companies to expand the list of functions available on an interconnection basis to include all services currently available to NTT customers. In particular, require NTT East and West to provide emergency services (110) to competitors at a tariffed rate. For services where NTT can prove to an independent authority that a “value added” charge is valid, NTT should be obligated to provide such services to competing carriers at wholesale rates.

V. Rights of Way and Access to Incumbent Facilities. The U.S. Government recommends that Japan develop unified regulations within CY 2001, to be implemented throughout the Japanese Government in FY2001, which will require NTT to provide transparent, non-discriminatory, timely and cost-based access to all poles, ducts, conduits, inside wiring, and rights of way that it owns or controls. Such regulations would:

- A. Require NTT to make available, on a timely basis, all necessary information about facilities it controls to which competitors are entitled access, and allow other carriers to inspect these facilities;
- B. Ensure that rates, terms and conditions for access and construction and use are reasonable, cost-based and non-discriminatory, vis-a-vis other carriers and NTT’s own services. MPHPT should consider requiring disclosure of how charges were calculated in order to ensure that contracts are fair;
- C. Establish clear rules for costs and burden sharing associated with surveys and facility modifications;
- D. Require survey, construction and installation be made on a non-discriminatory basis within a specified time frame;
- E. Permit competitive carriers to install and maintain their own facilities – including their own or leased fiber optic cable – located on NTT property;

- F. Ensure these requirements are subject to an expeditious complaint settlement procedure; and
- G. As priority measures, by the end of CY 2001, the U.S. Government suggests that the Japanese Government:
 - 1. Extend the interconnection obligations that MPHPT has placed on certain parts of NTT's networks (e.g. up to the manhole closest to the switch) to other bottleneck facilities, including conduits and ducts linking fiber loops and customer premises;
 - 2. Eliminate the "30-centimeter" rule that prohibits efficient use of utility poles for competitive carriers' cables;
 - 3. Eliminate the winter/spring road digging moratorium set by the Ministry of Land, Infrastructure, and Transport;
 - 4. Eliminate mandatory 5-7 year intervals between digging of certain roads;
 - 5. Explicitly permit trenching of cables, as opposed to installation of conduits and tunnels; and
 - 6. Consider application of items A through F cited immediately above to electricity companies, utilities, railroads, and highway operators.

VI. Resale/Unbundling. The U.S. Government recommends that in FY2001, MPHPT:

- A. For all wholesale service product lines where it is dominant (leased lines, directory assistance, etc.), require NTT to provide tariffed, wholesale rates; and
- B. Require NTT to provide LRIC-based access where competition has not developed to:
 - 1. Local loops, including: high-capacity lines; sub-loops; dark fiber, and inside wiring owned by a designated carrier;
 - 2. Inter-office transmission facilities, or transport, including dark fiber;
 - 3. Enhanced extended link (EEL), including a combination of an unbundled loop, multiplexing/concentrating equipment, and dedicated transport; and
 - 4. Any mandatory service (e.g. emergency services, directory assistance services) where it may be economically infeasible for competitors to replicate.

VII. Co-Location. To promote the expansion of services such as DSL and other high-speed data services, the U.S. Government recommends that MPHPT ensure that NTT:

- A. Charges competing carriers the same rate it charges an NTT group company;
- B. Justifies the basis for charges to the regulatory authority and any interested carrier;
- C. Undertakes construction within a set period from the date of application;
- D. Allows other carriers to carry out maintenance of their own facilities; and
- E. Ensures that carriers have access to operation support systems (order, supply, maintenance, recovery, billing, access) for services and facilities accessed through co-location arrangements.

VIII. Transparency. To promote greater transparency and accessibility relating to regulatory measures, the United States recommends that MPHPT:

- A. Publish all regulatory decisions and an electronic version of the telecommunications *roppo* online;
- B. Permit electronic filing of public comments and on-line access to all comments, tariffs, licenses and other public information, including all carriers' interconnection agreements with NTT East and West; and
- C. Provide a minimum of 30 days to comment on proposed rules, and a 60-day comment period to the maximum extent possible.

IX. Universal Service. The U.S. Government recommends that – based on further detailed analysis of costs incurred and implicit benefits received by NTT – Japan more thoroughly evaluate whether a universal service subsidy program for basic voice services is necessary. If a universal service subsidy program for basic voice services can be fully justified, the U.S. Government recommends that:

- A. Funding only be made available where, on a prefecture-by-prefecture basis, cost exceeds the LRIC of providing basic voice service by a substantial margin;
- B. Incumbents' costs be offset by advantages conferred by its incumbent, universal presence (e.g. marketing advantages, control of a platform for profitable, non-basic optional services, etc.); and

- C. The 72,000 yen per-line subscriber line charge already assessed on NTT East and West's 60 million subscribers be deducted from network costs forming the basis of the analysis.

- X. **ICAIS.** The U.S. Government recommends that MPHPT, together with METI, take the lead in exploring how Internet charging arrangements internationally can be subject to greater competition through identification of key bottlenecks, particularly in monopoly environments, where domestic inputs such as leased lines, backhaul costs, and limited choice of local telecommunications service providers result in inflated user costs.

INFORMATION TECHNOLOGIES

- I. Legal Framework.** To ensure that use of the Internet and e-commerce can thrive and spur economic growth, a legal framework in Japan that is appropriate for the digital age needs to be established and strengthened. Specifically, the United States urges the Japanese Government to:
- A. Continue to review and amend existing laws and regulations that require face-to-face or paper-based transactions, office locations in Japan, and similar measures that hinder e-commerce, in order to allow for electronic transactions in the consumer credit, health care and other sectors;
 - B. Enact and implement clear-cut Internet Service Provider liability rules that will balance the interests of service providers, web hosting firms, right holders and consumers. These rules need to protect carriers from liability for actions outside their knowledge and control. At the same time, the rules need to provide adequate protection for right holders through incentives or requirements for service providers to promptly remove illegal activity, such as infringement of copyrights, as well as provide adequate remedies for any injuries suffered;
 - C. Strengthen the protection of intellectual property rights on the Internet by taking necessary measures to ensure explicit protection of temporary copies under Japanese law, expeditiously ratifying the WIPO Performances and Phonograms Treaty, and examining other intellectual property protection laws that may need to be revised to meet the challenges of the digital age;
 - D. Work in conjunction with the private sector, both domestic and foreign, to review and make necessary adjustments to the legal and regulatory framework to ensure that new IT-based business models can be established and operate successfully; and
 - E. Ensure that foreign and domestic interested parties have the opportunity to review and comment on the Guidelines for Patenting and Know-how Licensing Agreements for software licensing currently being considered by the Japan Fair Trade Commission.

II. Privacy and Consumer Protection

- A. Privacy. Recognizing that the Diet is currently considering legislation on privacy, the United States urges the Japanese Government to utilize the Public Comment Procedure, providing a minimum 30-day comment period, and a 60-day comment period to the maximum extent possible, in developing any implementing ordinances and other measures required by the new law. In addition, the United States proposes that Japan take steps to support a self-regulatory framework for privacy and encourage the private

sector's development of authentication systems which do not unduly intrude on individuals' personal privacy.

- B. Consumer Protection. In order to promote a high level of consumer confidence in doing business online, the United States proposes that the Japanese Government take measures to promote the development of private sector self-regulatory initiatives for consumer protection and the resolution of consumer disputes (for example, greater utilization of Alternative Dispute Resolution).

III. Facilitating E-commerce

- A. Electronic Signatures. The United States recommends that the Japanese Government, in its efforts to implement the Law Concerning Electronic Signatures and Certification, take steps to ensure and clarify that the new law and its implementation are technology-neutral and do not require the licensing of certification entities by the Government. The United States urges the Japanese Government to:
1. Ensure that parties to a transaction may use any form of electronic authentication and may introduce that form as evidence in courts in Japan; and
 2. Confirm that parties to a B2B (business-to-business) transaction have the freedom to determine by private agreement the appropriate technological and business methods of authentication and to give such an agreement legal effect.
- B. Payment Systems via the Internet. The United States proposes that the Japanese Government discuss with it issues related to payment systems via the Internet such as standards, regulations, transparency, cross-border payments, cooperation against fraud and other issues to ensure that the respective approaches facilitate rather than hinder payments for online transactions.

IV. E-Government. The United States welcomes Japan's plan to create an IT-based interface between government, citizens, and business, and recommends that Japan take steps to ensure that e-government:

- A. Promotes open and transparent competition in IT procurement, not only at the central government level, but also by prefectures and local governments, including IT-related goods and services for educational purposes;
- B. Facilitates online interactivity between bidders and procuring entities in the procurement process, including public works; and
- C. Respects intellectual property rights and demonstrates leadership in APEC by creating a software asset management system.

PROPOSALS FOR COOPERATIVE EFFORTS

- V. **E-Education.** The United States proposes that the two governments discuss and formulate “e-learning” initiatives that could complement e-Japan plans to introduce and expand PC-based Internet use throughout Japan’s education system.
- VI. **Promoting the Use of IT and E-Commerce in the Private Sector.** The United States proposes that the two governments jointly and fully support the use of IT and e-commerce for all companies regardless of their size, as a way of increasing their efficiency, profitability and participation in the global marketplace. The United States encourages Japan to work with the private sector to improve and increase the opportunities for businesses, particularly start-ups and smaller firms, to secure the basic tools to do business online.
- VII. **Network Security.** The United States seeks to coordinate with Japan on issues concerning international cooperation to protect the integrity of the Internet, which is vitally important for the growth of e-commerce. For example, Japan and the United States can collaborate on the review of the 1992 OECD Guidelines for the Security of Information Systems. The United States also urges Japan to support the Council of Europe Convention on Cybercrime, an important tool for law enforcement and national security.

ENERGY

I. Independent Regulatory Authority. The U.S. Government has in the past recommended specific regulatory provisions to strengthen the Ministry of Economy, Trade and Industry's (METI's) independent regulatory authority over Japan's gas and electricity industries. To support the Japanese Government's determination to ensure through "relevant provisions" that METI's Electricity Market Division and Gas Market Division have independent authority over energy regulation, (including adequate resources), the U.S. Government recommends that METI clearly articulate and make public the regulatory provisions currently in place and those METI plans to put in place to ensure and promote independence.

II. Regulatory Process and Competition Policy

A. Clarification of Policy Goals. The U.S. Government recommends that the Japanese Government define the goals for the regulatory reform process in the energy sector and clearly define the type of market structure that Japan will adopt in the electric power and gas sectors (such as pool system, independent system operator, etc). The United States also recommends that the Japanese Government:

1. Establish a clear timetable for implementation of further policies to achieve these goals and establish the planned market; and
2. Conduct reviews of the electricity and gas market liberalization processes as scheduled by the Japanese Government, accompanied by an articulation of a concrete set of criteria and a timetable for monitoring progress leading up to these reviews.

B. Competition Policy Safeguards. To ensure that energy sector liberalization proceeds in a manner that promotes competition, including vigorous application of the Antimonopoly Act and its relevant guidelines, the U.S. Government recommends that:

1. METI and the JFTC cooperate to clarify interpretations of the Guidelines on Fair Electricity Transactions and the Guidelines on Fair Gas Transactions and to provide clear regulatory information to all market participants.
2. The JFTC ensure that its newly established IT and Public Interest Business Task Force actively monitors and vigorously investigates business conduct in the electricity and gas sectors and takes enforcement action against any such conduct found to be anti-competitive.
3. METI and the JFTC expeditiously make public any responses to requests for advice pertaining to the application of the Antimonopoly Act (AMA), as well as the incoming requests.

- C. Interaction with Advisory Councils. To promote market predictability and investment security, the U.S. Government urges that METI ensure that all existing and potential market participants have opportunities to provide input, either through formal participation or informal means, into the deliberations of the various advisory groups considering Japan's energy liberalization process. Further, the U.S. Government suggests that any draft recommendations proposed by these advisory bodies be published and open to public comment.
- D. Rulemaking Process. To maximize the opportunities for participation by interested parties in the development of regulations and other measures affecting the energy sector, the United States urges the Government of Japan to:
 - 1. Publish all solicitations of public comments in a central location, such as the *Kanpo*; and
 - 2. Allow a minimum 30-day comment period, except in urgent cases for which a 14-day comment period could be used, and to use a 60-day comment period to the maximum extent possible.

III. Electricity Sector. A competitive electricity market will promote Japan's goals of increased efficiency and reduced electricity costs. Achieving these goals will require changes in Japan's legal and regulatory framework to bolster open and non-discriminatory access to transmission and distribution grids, increase transparency of pricing and information, expand electricity infrastructure, and foster market entry.

- A. Access and Transparency. The initial steps METI has taken to promote fair and transparent treatment of wheeling service requests from new entrants have been helpful but not adequate in promoting transmission network access and information for new entrants. The U.S. Government recommends that METI take the necessary next steps toward creating the basic elements of a competitive electricity market, which include implementing the following measures:
 - 1. Unbundle generation from transmission, distribution, and other activities by taking additional steps to ensure that all competing generators have equal access to transmission services – providing an economic incentive for Japan's utilities to purchase generating services from the least-cost supplier;
 - 2. Unbundle retail services from transmission, distribution, and other activities by taking further steps to ensure that all competing retail service providers have equal access to necessary services – allowing Japan's consumers to purchase generating services from the least-cost supplier;

3. Provide transparent interconnection charges to transmission facilities for all market participants;
4. Develop and implement guidelines to make information on real-time electricity network usage publicly available;
5. Develop and implement guidelines for pricing and provision of transmission support network services (i.e., ancillary services), such as load balancing and load following;
6. Clarify and promote greater flexibility in terms and conditions of wheeling services to reflect real network usage (including revising supply contract restrictions and distinguishing between monopoly and competitive services), which will improve system reliability;
7. Develop and implement guidelines to make information on the price and availability of transmission services publicly available; and
8. Implement measures to promote greater accounting transparency (where it does not adversely affect competition).

B. New Construction of Transmission Infrastructure. Expanded infrastructure is necessary to make existing service areas more reliable and promote new entry. Accordingly, the U.S. Government recommends that METI:

1. Establish guidelines for determining the need for new transmission line construction, based on its commitment to monitor this need; and
2. Using these guidelines, develop incentives, within METI's jurisdiction, to promote new transmission line construction between electricity service areas.

C. New Entry of Competitive Generators. Given that METI's efforts to promote market entry to date have not yielded significant results, the U.S. Government recommends that METI take the following further steps to promote market entry:

1. Supplement its representation to conduct a study of existing regulatory requirements for siting of new generating units and transmission lines with a publicly available assessment of these requirements and potential for streamlining of those siting requirements within METI's jurisdiction by the end of JFY2001; and
2. Establish a concrete plan and timetable for the proposed JFY2002 privatization and sale of the Electric Power Development Company (EPDC) in a manner

that promotes competition in the electricity sector and provides a fair opportunity for all market participants to purchase EPDC assets.

IV. Natural Gas Sector. Based on environmental and energy security benefits, the Japanese Government has announced plans to increase the share of natural gas in its energy supply for electricity. METI has recognized that deregulation of the natural gas supply is crucial to the realization of these benefits, and to the successful deregulation of Japan's electricity supply. In light of recent international instability, Japan's own energy security should naturally be linked to timely infrastructure improvements in gas transmission and LNG facilities. Accordingly, the U.S. Government recommends that Japan promote open and non-discriminatory access to LNG terminal facilities and gas pipelines, transparent pricing of gas transport services, and incentives for construction of new pipelines and terminal facilities to meet growing demand. Further, to ensure that Japan can meet its goal of increasing natural gas usage to promote fuel diversity and reap the accompanying efficiency and price reduction benefits, the U.S. Government recommends that Japan take steps to ensure that deregulation of the natural gas sector proceeds in tandem with and does not hinder the deregulation progress in the electricity sector.

A. Access and Transparency. METI's efforts to promote fair and transparent treatment in transmission pricing and access in the gas sector have been less effective than those in the electricity sector. Therefore, the U.S. Government recommends that METI take the following necessary steps toward promoting a competitive gas and LNG market:

1. Unbundle transportation activities from marketing and other activities by implementing further measures to ensure that all competing suppliers have equal access to information on the price and availability of pipeline and LNG terminal services;
2. Direct the Gas Market Development Basic Issues Study Group – established by METI in January 2001 to assess Japan's gas market and the liberalization process – to provide a publicly available update of its findings by the end of JFY2001, including issues covered, conclusions, and proposals for gas market liberalization;
3. Provide transparent usage charges for pipeline and LNG facilities for all market participants; and
4. Develop and implement guidelines to make pipeline network and LNG terminal usage information publicly available.

B. New Construction of Transportation Infrastructure. To meet the Government of Japan's planned expansion of natural gas use, the U.S. Government recommends that METI:

1. Establish guidelines for determining the need for construction of new pipelines and LNG facilities; and
 2. Based on these guidelines, develop incentives, within METI's jurisdiction, to promote construction of new pipelines between the service areas of Japan's major gas suppliers and new LNG facilities within Japan's electricity service areas.
- C. New Entry of Competitive Gas Suppliers. Expanded transmission infrastructure is necessary to guarantee new entry by gas suppliers and electricity suppliers. Following publication of the list of major regulatory requirements for siting of new pipelines and LNG facilities, the U.S. Government recommends that METI use the list to conduct a publicly available assessment of these requirements and potential for streamlining of those siting requirements within METI's jurisdiction by the end of JFY2001.

MEDICAL DEVICES AND PHARMACEUTICALS

- I. Healthcare System Reform.** The U.S. Government welcomes Japan’s focus on introducing competitive forces and pursuing structural reform as mechanisms for improving its healthcare system. Such approaches are critical to providing higher quality care and to encouraging the development of innovative and cost effective drugs and devices. Specifically the U.S. Government supports the Council for Regulatory Reform’s (CRR) recommendations to:
- A. Increase the level of medical information available to the public. We recommend this be expanded to include further liberalization of advertising by medical institutions and direct-to-consumer advertising for medical devices and pharmaceuticals;
 - B. Improve the efficiency of receipt examination and payment obligations, including the expanded use of IT that would, for example, allow electronic transactions;
 - C. Modernize and improve the efficiency of medical institutions, including reform of the rules governing hospital ownership; and
 - D. Promote the establishment and management of nursing care facilities by private companies.
- II. Medical Device and Pharmaceutical Pricing Reform.** The special attention CRR has given to “resolution of the medical device equipment price gap between Japan and overseas” raises serious concerns. This approach suggests adoption of discriminatory measures (e.g., foreign reference pricing, that target foreign-made devices for arbitrary price cuts). Medical devices and pharmaceuticals are not cost-drivers. Faster availability and wider use of innovative drugs and medical devices can, in fact, dramatically reduce overall health care costs while improving the quality and efficiency of care. To ensure that the introduction of such products is encouraged and receives timely and “appropriate valuations,” the U.S. Government urges Japan to:
- A. Make needed progress to create transparent written rules that provide for prompt review and establishment of reimbursement categories and payment levels for new medical devices (C1 and C2) so as to make these products available to patients more quickly than once every two years;
 - B. Assure that medical devices are not subject to arbitrary price control measures (e.g., foreign reference price adjustments) to devalue innovative products;
 - C. Ensure that pharmaceutical pricing rules (e.g., cost calculation, etc.) are not changed to devalue innovative products;

- D. Reform pharmaceutical pricing rules (e.g., comparator, Olympic, premium and repricing) and initiate bold alternatives “that recognize the role of the market” to ensure appropriate valuations of innovation;” and
- E. Enhance the ability of U.S. medical device and pharmaceutical industries to be given “meaningful opportunities” to present their views to governmental entities and deliberative bodies undertaking pricing reform in this sector, and that those views are given “serious consideration.”

III. Medical Device and Pharmaceutical Regulatory Reform. In recent years, the Ministry of Health Labor and Welfare (MHLW) has implemented, and continues to implement, important reforms to expedite regulatory approvals of medical devices and pharmaceuticals. Nonetheless, there are important products that have not yet been introduced into Japan. Further progress in regulatory reform and global harmonization will allow Japanese patients to gain greater access to new medical treatments. It will also help free resources in the Japanese clinical trial system that would facilitate Japan’s participation in the development of innovative treatments currently being developed in other major markets.

- A. To continue improving the consistency and speed of approval processes for medical devices and pharmaceuticals, the U.S. Government encourages Japan to:
 - 1. Create special treatment within the existing new drug approval system to evaluate “legacy products,” (i.e., drugs that have a wide exposure in a geographically and ethnically diverse population and have not been previously registered in Japan, but are available in other major markets);
 - 2. Better clarify the criteria of the priority review process and establish procedures for expedited development of pharmaceuticals;
 - 3. Allow Clinical Investigators to receive financial incentives for conducting clinical trials; and
 - 4. Clarify the categories for medical device applications (including the definition of “me-too” applications) while taking into consideration the concept of “substantially equivalent;”
- B. Ensure that revisions to the Pharmaceutical Affairs Law, particularly those regarding manufacturing process and Quality System documentation, contribute to concrete improvements in regulation which neither create submission burdens on manufacturers nor establish technical or non-technical barriers to trade. The U.S. Government urges MHLW to ensure that such revisions are consistent with common international practices and allow all interested parties “meaningful opportunities” to comment on proposed revisions as well as to present alternatives that need to be given “serious consideration.”

(For example, the current GMPI requirement could be dropped, if the manufacturing site is in compliance with Quality System requirements as confirmed by an audit to assess compliance with ISO 13485 and not to a unique, local standard.)

IV. Acceptance of Foreign Clinical Data. Broader use of foreign clinical data in the approval of pharmaceuticals is key to expediting availability of innovative drugs for Japanese patients and helping to unburden Japan's clinical trial system, which would help free resources in the Japanese clinical trial system that would facilitate Japan's participation in the development of innovative treatments currently being developed in other major markets.

A. The U.S. Government urges the MHLW to continue its good faith efforts to work within the International Council on Harmonization (ICH) process to resolve the issues regarding the implementation of the ICH E5 guideline, including:

1. Affirm that the three relevant ethnic groups in the assessment of ethnic sensitivity are Asian, Black and Caucasian, and eliminate unilateral ethnic distinctions;
2. Ensure that the assessment of ethnic sensitivity is based on the clinical relevance of the data; and
3. Consider the implementation of a bridging justification concept to ensure transparency and consistency in requests for bridging studies.

B. The U.S. Government urges MHLW to:

1. Ensure that the Organization for Pharmaceutical Safety and Research (OPSR) expands the use of global scientific norms in its consultations with industry; and
2. Ensure that there is complete coordination between OSPR and the Pharmaceutical and Medical Device Evaluation Center with regard to agreements reached during consultations.

V. Nutritional Supplement Liberalization. The U.S. Government recommends that Japan to continue to deregulate the sale of nutritional supplements and to expand the range of products for which relevant labeling information may be provided, including herbs.

FINANCIAL SERVICES

- I. Specific Measures.** The United States welcomes deregulation in the following areas at the earliest possible date:
- A. Permit the Postal financial institutions (*Yucho* and *Kampo*) to employ the services of investment advisory companies through direct onshore trust arrangements (*tokutei shintaku*) without the requirement to convert asset positions into cash before changing asset managers;
 - B. Allow defined contribution plan providers to submit for review and approval prototype DC pension plans that could then be adopted by plan-sponsoring companies upon notification of the authorities, without requiring further review and approval;
 - C. Eliminate the requirement for physical certificates for privately placed fixed income securities and investment trusts;
 - D. Permit multiple classes of shares for investment trusts to provide more flexibility and efficiency in structuring products;
 - E. Require full mark-to-market accounting for all investment trusts in order to protect investors;
 - F. Revise the E-Notification Law to include lenders subject to the money lending business law, to allow customers who have consented to electronic notification to receive notification by electronic means; and
 - G. Work closely with the private financial services community to review current requirements for financial institution reporting and record keeping, and revise or remove overlapping or duplicative disclosure and reporting requirements. Allow financial institutions to maintain records in electronic form, and where possible, to distribute reports and filings by electronic means.
- II. Transparency.** To improve transparency in financial sector regulatory and supervisory practice, the United States would welcome measures in the following areas at the earliest possible date:
- A. To encourage the successful development of the newly initiated defined contribution pension industry, we request that:
 - 1. The Government of Japan create a unified regulatory regime with a clear division of responsibility, based on function, between the Ministry of Health, Labor and Welfare and the Financial Services Agency.

- B. In line with the announced goal of carefully reviewing the activities of public sector corporations and avoiding competition with the private sector, we request that any new financial service activities proposed for the Postal Financial Institutions (*Yucho* and *Kampo*) be the subject of full public notice and comment and consideration before their introduction.
- C. The operations and decision making of industry associations that have a self-regulatory, investor protection, or other public policy role should be conducted in a transparent and open fashion. Specifically, the United States recommends that:
1. Proposed rulemaking by industry associations should be made available for public comment, and that comments received from the public should be taken seriously in the formation of final rules governing association members;
 2. Written materials – including regulations, supervisory standards and other guidance, operating rules and procedures, market studies, and other statistical compendia – should be made available to the public at reasonable costs of production and duplication; and
- D. As a complement to self-regulatory organizations, we request that the Japanese financial authorities encourage and work with private sector financial industry associations that represent the views and the expertise of their members.

COMPETITION POLICY

- I. Independence and Staffing of the JFTC.** In order for the Japan Fair Trade Commission (JFTC) to be an effective agency that is capable of fulfilling its basic mission, it must enjoy both the fact and perception of true independence. It must also have sufficient resources both to enforce the Antimonopoly Act (AMA) and to promote competition across the economy. The United States recommends that Japan:
- A. Change the organizational status of the JFTC from an organ under the Ministry for Public Management, Home Affairs, Posts and Telecommunications (MPHPT) to an independent agency under the Cabinet Office; and
 - B. Commit to a substantial and steady increase in the personnel levels of the JFTC over the next five years, including approval of the JFTC's request for a 69 person net increase in FY2002.
- II. JFTC Investigatory Capabilities.** The JFTC's investigatory tools need to be brought up to modern international standards if it is to be successful in uncovering unlawful activity that harms Japan's economy and Japanese consumers. Specifically, the United States urges that Japan:
- A. Cooperation Leniency Program
 - 1. Announce the JFTC's intention to adopt a cooperation leniency program, under which it will exclude from its recommendations, surcharge payment orders and/or criminal accusations, enterprises that notify the JFTC of unlawful practices and cooperate fully with the JFTC's investigation; and
 - 2. Empower the JFTC to exclude cooperating enterprises from surcharge payment orders.
 - B. Criminal Procedures
 - 1. Provide the JFTC with search and investigative powers for criminal violations of the AMA similar to those enjoyed by the National Tax Administration; and
 - 2. Normalize the criminal accusation procedure for AMA violations to be the same as agency accusation procedures for other crimes.
 - C. Interference with Investigations. Increase substantially the penalties for interference or non-compliance with JFTC investigations and announce a new policy that such practices will be actively prosecuted.
 - D. Information Technology and Public Utilities Sectors

1. Ensure that the JFTC's newly established IT and Public Interest Business Task Force has adequate staff and expertise to actively monitor and vigorously investigate business conduct in the information technology and public utility sectors and to take enforcement action against any such conduct found to be anticompetitive; and
2. Give serious consideration to actively recruiting outside experts from business or academia for fixed-term employment with the IT and Public Interest Business Task Force.

III. Effectiveness of AMA Enforcement Actions. The elimination and prevention of anticompetitive conduct requires the imposition of severe economic consequences on companies found to have violated the AMA. It also requires that both the JFTC and the courts are given flexible and broad powers to order violators to take actions necessary to ensure that such conduct not only is terminated but does not recur. To these ends, the United States recommends that Japan:

A. Surcharge Payment Orders

1. Strengthen the deterrent effect of surcharge orders by:
 - a. Eliminating the three-year cap on the sales subject to surcharge orders;
 - b. Modifying the surcharge rate applicable to small- and medium-sized enterprises to ensure that the surcharge fully disgorges the benefits such firms receive from the anticompetitive practices; and
 - c. Allowing the JFTC to waive imposition of the full surcharge where severe hardship would otherwise result (if deemed necessary in order to effectuate the above changes).
2. Extend the scope of surcharge payment orders to cover buying cartels, private monopolization, and complementary bidding, where such activities affect the price at which goods or services are purchased or sold.

B. Elimination of Anticompetitive Conduct. Increase the scope and effectiveness of cease-and-desist orders and other elimination measures under the AMA so as to strengthen the JFTC's ability to eliminate anticompetitive conduct and ensure that it does not reappear. Specifically, the United States recommends that Japan:

1. Lengthen significantly the one-year period after cessation of illegal conduct within which JFTC must issue elimination measures; and

2. Authorize cease-and-desist orders against all violations of the international contract (AMA §6) or trade association (AMA §8) provisions of the AMA, even where the unlawful conduct has already been terminated.
- C. Private Remedies. Review the private AMA injunction system, with a view toward extending the system to cover all unreasonable restraints of trade (AMA §3) or violations by trade associations (AMA §8).

IV. Elimination of Bid Rigging. The prevalence of bid rigging in procurements by Japanese Government entities wastes resources and undermines the public's confidence that the Japanese Government truly believes in competition principles, especially where bureaucrats actually assist *dango* activities. In order to eliminate *dango*, the United States recommends that Japan:

- A. Bureaucrat-led (*kansei*) *Dango*. Submit legislation to the Diet aimed at effectively addressing the problem of the complicity of government procurement officials in bid rigging activities, including such measures as:
1. Empowering the JFTC to issue formal recommendations to central and local government procuring entities to cease practices that are assisting bid rigging activities and to take specific measures to prevent recurrence of such assistance or complicity;
 2. Requiring procuring entities to investigate alleged *kansei dango* activities and to take strict disciplinary action against responsible officials found to be engaging in activities to assist bid rigging;
 3. Assigning authority to appropriate officials, such as an inspector-general office, to independently investigate evidence of *kansei dango* and to recommend disciplinary action; and
 4. Subjecting all public corporations to JFTC recommendatory action, as well as to the obligations for investigating and taking disciplinary action against officials that assist bid rigging.
- B. Prevention and Deterrence of *Dango*
1. To realize the goals of the Act for Promoting Proper Tendering and Contracting for Public Works (Act) and the Guiding Principle, implement measures to be taken by the Ministry of Land, Infrastructure and Transport (MLIT) (together with the Ministry of Finance and MPHPT or on its own) to, *inter alia*, prevent and deter *dango* activities, such as:

- a. Preparing and publishing by the end of FY2001 a model manual which includes:
 - i. procedures for procurement officials to follow in reporting facts that point to the likelihood of *dango* activity to the JFTC and local police or prosecutors, including the designation of one or more appropriate procuring entity officials who are authorized to receive pertinent information from procurement officers and to forward relevant facts on *dango* activity to the JFTC;
 - ii. information on how to identify facts that may raise suspicion of *dango*;
 - iii. a clear statement of the policy of the procuring entity prohibiting any assistance by its officials in *dango* activities and the disciplinary measures that will be taken against officials found to have engaged in such assistance;
 - iv. procedures for implementing “suspension of designation” of firms suspected of engaging in *dango*; and
 - v. procedures for seeking damage compensation for the procuring entity from firms and individuals for overcharges resulting from *dango*.
 - b. Establishing regular education and training programs for procurement officials on how to prevent unlawful *dango* activities and on the procedures for reporting facts raising suspicion of *dango* to the JFTC and local police or prosecutors; and
 - c. Ensuring that all central government agencies, quasi-governmental entities, and prefectural governments prepare annual public reports that detail measures they have taken to comply with the Act and the Guiding Principle, and that evaluate the effectiveness of those measures in addressing *dango*.
2. Introduce an administrative anti-*dango* program under which all bidders on central government, prefectural government or quasi-governmental entity procurements would be required to submit written certifications that they have not discussed their bid or exchanged bidding information with any other bidder. Establishment of appropriate statutory or administrative sanctions (such as suspension of designation) for untruthful certifications would make this program substantially more effective.

- V. **Competition and Regulatory Reform.** If Japan’s efforts at achieving regulatory reform are to successfully revitalize its economy, Japan must place a priority on promoting real competition that is not undermined by informal administrative guidance or private sector re-regulation. In order to promote truly successful regulatory reform, the United States recommends that Japan:
- A. Prevention of Anticompetitive Administrative Guidance and Private Sector Re-Regulation. Devote additional JFTC resources to monitor recently deregulated sectors to ensure that government regulations are not replaced by anticompetitive administrative guidance or re-regulation by private sector restrictions (*min-min kisei*).
 - B. Promotion of Competition in Regulated Sectors
 - 1. Advance joint efforts by the JFTC and METI toward introducing and preserving effective competition in the electricity and gas sectors;
 - 2. Encourage additional cooperation between the JFTC and MPHPT toward introducing and preserving effective competition in the telecommunications sector; and
 - 3. Promote joint efforts between the JFTC and MLIT toward introducing and preserving effective competition in the transportation sector.
 - C. Regulatory Reform. Promote joint efforts between the JFTC and the Council for Regulatory Reform to identify necessary measures to reduce regulations and promote competition in the Japanese market.
 - D. Privatization of Public Corporations. Ensure that the restructuring and privatization of public corporations is accomplished in a manner that does not impede, and in fact enhances, competition, including by having the JFTC review and provide input from a competition policy perspective on any such privatization or reorganization plans.
 - E. Manufacturer/Distributor Equity Ties. Initiate a JFTC survey on “highly oligopolistic industries” that focuses on the extent and form of financial inter-relationships linking manufacturers and distributors, and covers equity ties, provision of loans or other capital sources and the sharing of employees, facilities and equipment.

TRANSPARENCY AND OTHER GOVERNMENT PRACTICES

I. Public Comment Procedures. Japan's adoption in 1999 of Public Comment Procedures (PCP) offered the potential of filling a significant gap in its regulatory system by allowing all interested parties to review and submit comments on draft regulations before they are finalized and implemented. However, after two years of implementation of the PCP, there are serious concerns with the effectiveness of the Procedures. Surveys conducted by the Ministry of Public Management, Home Affairs, Posts and Telecommunications and a predecessor entity (the Management and Coordination Agency) on the use of the PCP since their implementation point to deficiencies in the Procedures. The majority of comment periods were less than 30 days. Also, the comments are having little, if any, impact on the final regulations. According to the FY2000 survey, final regulations were revised to respond to public comments in less than 20 percent of the cases in which PCP use was required, and even in those cases, few of the revisions appear to be substantive. The survey results fuel a growing perception that the PCP are serving little purpose, and that governmental agencies are working out draft regulations with special interests before they are published for public comment (as was the practice before the PCP process was introduced). To address these concerns, and to make the PCP a useful and effective regulatory mechanism, the United States urges the Japanese Government to take the following measures:

- A. Establish a central registry, such as publication in the *Kanpo*, for all solicitations of public comments, whether or not they are covered by the PCP. Such a registry would be in addition to the various means currently used by governmental agencies for solicitations of comments, and would include solicitations of public comments by *shingikai*, *kenkyukai*, *benkyokai* and other study groups;
- B. Require use of a minimum 30-day comment period, except in urgent cases for which a 14-day comment period could be used, and recommend use of a 60-day comment period to the maximum extent possible;
- C. Prohibit governmental agencies from informally addressing concerns regarding draft regulations with private sector entities (outside of the advisory council process) prior to solicitation of public comments on the regulations, or as an alternative require government agencies to disclose publicly all such contacts;
- D. Authorize the courts or an independent oversight body to review complaints regarding the use (or non-use) of the PCP in particular cases and to direct governmental agencies to take remedial action where necessary;
- E. Expand the scope of measures for which public corporations are required to use the PCP (Section 1, note 7 of the PCP) to include any regulatory measures that such corporations plan to adopt;

- F. Establish a study group that includes Japanese and foreign private sector representatives to examine the effectiveness of the PCP and to make appropriate recommendations; and
- G. Require all industry associations and other self-regulatory organizations that are established under the authority of a law to introduce public comment procedures.

II. Administrative Guidance. Despite the transparency provisions in the Administrative Procedure Act, administrative guidance has been issued in writing in only a small number of cases. In order to increase the transparency and predictability of the Japanese regulatory system, the United States recommends that the Japanese Government, consistent with the Structural Impediments Initiative Reports, take necessary measures to:

- A. Reduce the use of administrative guidance; and
- B. Require all administrative guidance to be issued in writing, with only narrow exceptions allowed.

III. Public Participation in Development of Legislation. Governmental agencies generally do not provide an opportunity for interested parties, other than those represented on advisory councils or with special access, to have input into the development of legislation. The United States recommends that the Japanese Government develop a mechanism that would enable all interested foreign and domestic parties to review and comment on draft legislation before governmental agencies submit the draft legislation to the Diet.

IV. Judicial Review of Administrative Actions. The administrative actions that are reviewable by Japanese courts are narrowly circumscribed. The United States recommends that the Japanese Government augment judicial oversight over governmental agencies by expanding the types of administrative actions that may be reviewed by the courts as well as by expanding the parties that are allowed to ask the courts to review agency actions.

V. Public Corporations. The United States notes with interest Prime Minister Koizumi's drive to restructure and privatize Japan's public corporations. The United States also recognizes that, if implemented vigorously, this reform effort could have a major impact on the Japanese economy, stimulating competition and efficiency and leading to a more productive use of resources. In its reform of public corporations, the United States urges Japan to:

- A. Conduct the restructuring and privatization in a transparent manner; and
- B. Ensure that domestic and foreign private sector entities that will or may be affected by the reform have an opportunity to provide input, such as through use of the Public Comment Procedures.

VI. Regulatory Impact Analysis. Building on Japan’s three-year regulatory reform program and its Policy Evaluation System, the United States proposes that the Japanese Government introduce a government-wide Regulatory Impact Analysis (RIA) system that would:

- A. Apply cost/benefit analysis (both quantifiable and non-quantifiable) to proposed regulatory changes that are likely to have a significant economic impact;
- B. Use the best available scientific, technical, and economic data when reviewing proposed regulations; and
- C. Provide an opportunity for interested parties and the public in general to comment on the cost/benefit analyses, as well as on the reasonableness of the assumptions and methodologies used.

VII. Postal Financial Institutions. The U.S. Government shares the concerns voiced by Keidanren and others related to the effect of the postal financial institutions – postal savings (*yucho*) and postal insurance (*kampo*) – on the efficient operation of Japan’s financial markets. The transfer of business of the three postal services (mail delivery, savings, and insurance) of the Postal Services Agency to a public postal corporation in 2003 provides an important opportunity for the Japanese Government to take concrete steps to address key transparency and competition issues related to these organizations.

- A. Transparency. The U.S. Government welcomes recent steps that the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) has taken to make the 2003 transfer of the postal services from the Postal Services Agency to a public postal corporation more transparent, including the inclusion of two foreign private sector representatives on its “Study Group on the Postal Services Public Corporation.” However, the process for, and possible effects on, the private sector from the transfer remain insufficiently clear. To remedy this, the U.S. Government urges the MPHPT to take steps to sufficiently inform and seek input from the public (including foreign insurers) on all aspects of this transfer that may affect private sector operations in the relevant sectors. This includes affording the insurance industry and other private financial service providers (both domestic and foreign) meaningful opportunities to be informed of, comment on, and exchange views with MPHPT officials on:
 - 1. MPHPT-proposed plans and draft legislation prior to their submission to the Diet; and
 - 2. Draft guidelines and other regulatory measures prior to their implementation, with full utilization of the Public Comment Procedures.
- B. Curb Expansion. In transferring the postal services and establishing a public corporation in 2003, the United States recommends that Japan prohibit the postal

financial institutions (*kampo* and *yucho*) from underwriting any new insurance products or originating any new non-principal-guaranteed investment products.

- C. Same Standards of Regulation. In transferring the postal services and establishing a public corporation in 2003, the United States recommends that, in order to create a level playing field between the postal financial institutions and their private sector competitors, Japan subject the postal financial institutions to the same standards of regulation as their private sector counterparts.
- D. Privatization. The U.S. Government notes that Prime Minister Koizumi has established a private panel to make recommendations on how to deal with postal services organizations (including the postal financial institutions), including possible privatization of these entities. As any modifications to the existing system could have a significant impact on competition in, and the effective operation of, the broader insurance marketplace in Japan, it is important that any decisions be made and implemented in an open and transparent manner. This would include the same measures as outlined above in VII A.

LEGAL SYSTEM AND INFRASTRUCTURE

I. Legal Services

A. Unrestricted Freedom of Association between *Bengoshi* and *Gaiben*. The most critical structural deficiency in Japan's international legal services sector is the severe limitations on the relationships permitted among Japanese lawyers (*bengoshi*) and registered foreign lawyers (*gaikokuho jimu bengoshi* or *gaiben*). The United States urges the Japanese Government to eliminate all prohibitions against freedom of association between *bengoshi* and *gaiben*, and to allow them, as equal legal professionals, to determine their own forms of association. The principle underlying the reform should be unrestricted freedom of association between and among *gaiben* and *bengoshi*, as is permitted in other advanced countries. The United States further urges the Japanese Government to undertake the deregulation recommended above rather than experiment with additional changes to the *tokutei kyodo jigyo* (joint enterprise) system. That system has shown, after six years of experience, that it does not provide the framework needed for effective teamwork between *bengoshi* and *gaiben*.

B. Restrictions on *Gaiben*

1. The United States recommends that the Japanese Government remove discriminatory restrictions on *gaiben* and accord *gaiben* and *bengoshi* equal treatment. In particular, the United States recommends that the Japanese Government:
 - a. Allow *gaiben* to employ *bengoshi* on the same basis that *bengoshi* are allowed to hire foreign lawyers; and
 - b. Discontinue the discriminatory treatment of *gaiben* with regard to the provision of legal advice on third-country law (*i.e.*, the law of a country other than Japan or the jurisdiction in which the *gaiben* is registered).
2. The United States urges the Japanese Government to allow foreign lawyers to count all of the time in Japan spent practicing the law of the lawyer's home jurisdiction toward meeting the experience required to register as a *gaiben*, not just the one year allowed under current practice.
3. The United States proposes that the Japanese Government allow *gaiben*, like *bengoshi*, to establish professional corporations, limited liability partnerships (LLPs), and limited liability corporations (LLCs), as long as they comply with other requirements of the Foreign Lawyers Law.

C. Improvements of *Gaiben* Regulatory System

1. The United States proposes that the Japanese Government ensure that the Japan Federation of Bar Associations (*Nichibenren*) and the mandatory local bar associations provide *gaiben* with effective opportunities to participate in the development and enforcement of all laws and rules that affect them.
2. The United States proposes that the Japanese Government reduce the time required for *gaiben* applicants to register as *gaiben*, including any appeals, by expediting and rationalizing the reporting process for *gaiben*.

II. Legal System Reform

A. Implementation of the Judicial Reform Council's Recommendations

1. *Increase in the Number of Legal Professionals.* One of the most important JRC recommendations relates to the need to increase significantly the number of legal professionals in Japan. The United States urges the Japanese Government to increase expeditiously the number of persons who pass the Judicial Examination to a minimum of 1,500 per year, and to establish a schedule for increasing the number of persons who pass the Judicial Examination to 3,000 per year.
2. *Reform of the Arbitration Law.* The United States urges the Ministry of Justice to establish an advisory council to make recommendations for the reform of Japan's Arbitration Law, consistent with the JRC's recommendations.
3. *Increase the Speed and Efficiency of Civil Litigation.* The United States urges the Japanese Government to expeditiously implement the following recommendations of the JRC:
 - a. Reduce the length of trials by 50 percent;
 - b. Increase significantly the number of judges and court personnel, as well as the number of *bengoshi*;
 - c. Facilitate pre-trial and pre-complaint evidence-gathering for litigation; and
 - d. Improve litigation of intellectual property disputes, including through bolstering specialized IPR departments at the Tokyo and Osaka District Courts and through facilitating the involvement of experts as witnesses, advocates and court personnel.

4. *Strengthen Judicial Oversight over Administrative Agencies.* Greater legal accountability of administrative agencies will increase fairness and confidence in administrative activities. Consistent with the recommendations of the JRC, the United States recommends that the Japanese Government undertake a full review of the means of promoting administrative agency accountability through the courts, including review of the Administrative Case Litigation Law.
5. *Reduce Filing Fees for Civil Litigation.* The United States recommends that the Japanese Government establish a fixed filing fee, or greatly compressed sliding scale fee system, in order to ensure that the filing of meritorious lawsuits is not discouraged.

B. Improvements in the Japanese Judicial System

1. *Improve Evidence-Gathering Methods.* To improve evidence-gathering methods, the United States recommends that Japan:
 - a. Impose sanctions for inadequate responses to inquiries pursuant to Article 163 of Civil Procedure Code (CPC);
 - b. Narrow the self-use exception under CPC Article 220; and
 - c. Provide for inspection of facilities by litigants.
2. *Augment Protection of Trade Secrets during Court Hearings.* The United States recommends that the Japanese Government develop a comprehensive solution to address the problem of disclosure of trade secrets during the course of open hearings. Appropriate measures could include allowing for *in camera* (restricted judicial) review of evidence that contains trade secrets.
3. *Clarify the Attorney-Client Privilege.* The United States recommends that Japan create an express and statutorily-based attorney-client privilege to ensure full respect for this principle.
4. *Make Judicial Remedies More Effective.* The United States proposes that Japan improve the ability of courts to issue and enforce prompt and effective orders through such measures as expanding the scope of civil lawsuits in which injunctive remedies may be obtained and strengthening the power of courts to design injunctive orders that are likely to be effective.
5. *Increase Transparency of Judicial Proceedings.* The United States recommends that the Japanese Government make the judicial system more

accessible to the public and business community by providing greater and more timely access by all persons to court records and decisions.

COMMERCIAL LAW

- I. Cross-Border Share Exchanges.** Cross-border share exchanges are an important and useful tool for effecting a variety of transactions in international business, including cross-border stock-for-stock mergers and acquisition transactions, corporate restructuring through share exchanges and joint ventures between Japanese and foreign firms. The inability under current Japanese law to utilize these share exchange techniques impedes foreign investment in Japan, and with it the flow of needed technology and managerial know-how into Japan. As part of the current “drastic overhaul” of the Commercial Code to be completed by Spring 2002, the United States recommends that Japan permit and promote cross-border share exchanges, taking into account the provisions of Article 352, *et seq.* of the Commercial Code, which permit and promote share exchanges between domestic firms.
- II. Flexibility in Capital Structure.** Expansion of the tools that firms have to raise capital, obtain services and provide incentives to both managers and employees is crucial to Japan’s efforts to restructure and reinvigorate its economy. Although Japan has taken some steps already in this regard, further measures are needed if start-ups and existing companies are to maximize their ability to respond to changing capital and other market demands. To achieve this goal, the United States recommends that Japan take the following measures:
- A. Provide that cash may be used as an acceptable form of consideration in any merger transaction so that companies can be taken completely private through compulsory tender of shares by “holdout” minority shareholders after a successful takeover;
 - B. Revise the current court-supervised inspection procedure for valuation of in-kind capital contributions to place responsibility for deciding such valuation with the board of directors without any requirement that lawyers and accountants conduct such valuation, and refrain from subjecting lawyers and accountants conducting appraisals to strict liability for erroneous valuations;
 - C. Eliminate limits on the quantity of stock options than can be issued and restrictions on recipients of stock options, so that stock options can be distributed to, among others, consultants, service providers, and employees of affiliates;
 - D. Abolish the limit on the issuance of non-voting shares, at least upon approval of shareholders;
 - E. Permit classes of shareholders of closely held corporations that have issued more than one class of shares to elect a specified number or percentage of the board; and
 - F. Remove the prohibition against transfers of new subscription rights.

III. Corporate Governance. One of the key changes needed to improve the performance of Japanese companies is the strengthening of corporate governance mechanisms, both to provide greater flexibility in management structures and to increase accountability of management to shareholders. In this regard, the United States recommends that Japan take the following measures:

- A. Provide publicly traded companies the option of adopting a corporate management structure that includes an executive office system and a board committee system in which at least the audit, nomination and compensation committees include, at a minimum, a majority of outside directors, instead of continuing to use the traditional *kansayaku* (statutory auditor) system;
- B. Ensure that, if Japan decides to require certain companies to appoint outside directors, such an obligation applies only to publicly traded companies or, if that is not feasible, only to companies whose articles of incorporation do not require that the transfer of their common shares be approved by their board of directors;
- C. Modify the definition of “outside director” to ensure that such directors are truly “independent,” including by excluding employees and ex-employees of companies with significant cross-shareholders with, or in the same *keiretsu* as, the company;
- D. Allow resolutions of the board of directors to be taken by telephone conference or by unanimous written consent;
- E. Maintain the current unlimited liability of directors in shareholder derivative lawsuits for breaches of the duty of loyalty, intentional misconduct, knowing violation of law or receipt of personal benefit, and ensure that any changes to the shareholder derivative system do not undermine the principle of board accountability to shareholders;
- F. Permit companies to use the Internet and other electronic means (e.g. facsimile, telephone) for notice of shareholders’ meetings, timely release of meeting materials, exercise of shareholders’ rights to vote on resolutions, and other procedures which currently must be completed by paper documents;
- G. Reinforce the obligations of fiduciaries that manage pension funds to exercise reasoned judgment concerning the interests of trust beneficiaries with regard to voting the shares under their management; and
- H. Ensure that financial statements accurately represent the financial condition of a company by supplementing progress in adopting internationally accepted accounting standards with strict enforcement of the implementation of those standards through outside audits conducted in accordance with internationally acceptable auditing standards.

IV. Statutory Agents. The imposition of joint and several liability on the statutory agents of foreign corporations would make it very difficult for foreign companies to find persons willing to act as their statutory agent, and would therefore impose serious obstacles on the ability of foreign firms to operate in Japan. Accordingly, the United States urges Japan to reject any proposal to require foreign corporations to appoint statutory agents that are jointly and severally liable for the obligations of the corporation.

V. Public Input into Commercial Law Revision Process. Since the international business and legal communities, just as the Japanese business and legal communities, will be directly affected by changes to Japan's Commercial Code and other commercial laws, it would be both equitable and reasonable to provide the international business and legal communities with opportunities to provide input into the revision process. To this end, the United States urges Japan to take the following measures:

- A. Provide the international business and legal communities with meaningful opportunities to provide input into the formulation of recommended revisions to Japanese commercial law, in the same manner as provided to domestic business and legal circles, including for example granting a foreign representative observer status at the Company Law Subcommittee of the Legislative Council's Commercial Code Working Group; and
- B. Ensure that the Legislative Council and any other advisory councils that prepare recommendations on Commercial Code revision solicit public comments on their proposals before they are finalized.

DISTRIBUTION

- I. Nippon Automated Cargo Clearance System (NACCS).** Japan's willingness earlier this year to take into account the concerns of companies faced with increased fees for the use of NACCS for air cargo is a welcome acknowledgment of the importance of keeping in check the cost of moving goods into the distribution system. The U.S. Government urges Japan to:
- A. Continue its dialogue with companies to ensure that a fee structure equitable to all Air NACCS users can be installed after the expiry of the current three-year arrangement.
- II. Simplified Declaration Procedures.** Japan's adoption this year of Simplified Declaration Procedures for the clearance of imported goods is welcomed by the United States. In its explanation of the new procedures, the Ministry of Finance notes that similar systems are used in the United States and Europe and that the adoption of simplified procedures in Japan will "contribute to promoting international harmonization in customs procedures which will facilitate trade." While welcome, the implementing regulations for these new procedures are so restrictive as to make them practically unusable for many air shipments. Thus, the simplified declaration procedures as they are now implemented are not in harmony with U.S. and European practice and do not accommodate the needs of those companies which facilitate the import of a rapidly growing proportion of total shipments into Japan. The United States urges Japan to amend the implementing regulations for the Simplified Declaration Procedures to bring them into line with U.S. and European practice in the following manner:
- A. Approve integrators/agents as "importers" for the purpose of implementing the procedures. This would not necessarily require that agents/integrators be the Importer of Record; and
- B. For the purposes of the procedures, include in the definition of approved goods those goods designated for door-to-door transportation. This would avoid the need for specificity when designating the goods to be imported.
- III. *De Minimis*.** In order to further facilitate the speedy import of small goods and packages into Japan (and to reduce administrative costs), the United States urges Japan to:
- A. Increase the *de minimis* value in the Customs Clearance Law from 10,000 yen to 30,000 yen. Such a move would also produce a significant reduction in personnel costs to the Japanese Government.