INVENTORS' NETWORK of the Capital area (INCA)

April 21, 2003 Meeting

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Presentation Topics:

1) Licensing New Inventions: The Black Box Dilemma

2) International Licensing: Cultural Considerations

3) Technology Licensing: Royalty Setting

INCREASING IMPORTANCE OF INTELLECTUAL PROPERTY

We are living in a "Golden Age" for intellectual property rights (IPRs). Bill Gates speaks of a new "Gold Rush." Others consider IPRs a new and different "Bull Market." Patent filings and issuances have been skyrocketing, so much so that there is talk of a patent "revolution", "explosion", "frenzy". The U.S. Patent & Trademark Office (USPTO) is granting now almost 200,000 patents, almost three times as many as in 1980. Trademarks have experienced a similar boom. And trade secrets are said to be the "IPRs of the new millennium and can no longer be treated as a stepchild."

The American Patent System was revitalized by the creation in 1982 of the Court of Appeals for the Federal Circuit (CAFC), considerable pro-patent legislation in recent years as well as less antitrust enforcement.

"Everything under the sun made by man" is patentable according to our Supreme Court interpreting our Congress (*Chakrabarty* decision, 1980). And as of 1998 even formerly unpatentable business methods and computer programs (algorithms) are now also patentable (*State Street Bank* decision, CAFC, 1998).

More than ever companies are built around patented technology. The rate of American innovation is soaring. "New ideas are fostered in America like no place else on Earth." (*US News & World Report*, 1/4/99, p.40) "U.S. entrepreneurs power era of unprecedented prosperity" (*USA TODAY*, 7/30/99, p.B1) "Innovate or perish" is the motto. In recent years, royalties obtained for licensing patents have exceeded the billion-dollar mark for companies such as TI and IBM and over 100 billion dollars for all U.S. industries.

And universities, not to be left out, have jumped on the bandwagon. They now obtain thousands of patents annually and conclude an equal number of licenses per year. And the amount of royalties universities reap from patent licenses is also soaring. Annual patent royalty revenues rose from $275 million in 1995 to over $1 billion as of 2001, with a couple of universities already garnering over $100 million per year.

Courts read the riot act to infringers. Holding patents valid much more often nowadays, they award damages in the hundreds of million dollars and even exceeding a billion dollars. Preliminary injunctions and treble damages are no longer rare and permanent injunctions are no longer stayed during appeals. According to Eric Belt of Bromberg & Sunstein the "year 2002 was truly the year of the plaintiff in patent litigation. As a result, patents should become even more valuable as business assets in 2003 and beyond."

Thus, we now have in the U.S. a thoroughly pro-patent climate, where patents are more enforceable and valuable and it no longer pays to infringe like before when, in the unlikely event the patent in suit was upheld, only reasonable-royalty damages were assessed. Ronald Myrick of General Electric put it this way: "The attraction of IP is simple; it's at the forefront of the technology that's driving the world and IP is one of the unique entities in the law where you're actually creating assets.

LICENSING NEW INVENTIONS
THE BLACK BOX DILEMMA

The Black Box Dilemma:

- The Inventor can't "let the cat out of the bag"
- The potential licensee won't "buy a pig in a poke"

The solution:
Secrecy Agreement
Non-disclosure Agreement
Confidential Disclosure Agreement
Pre-negotiation Agreement

LICENSING NEW INVENTIONS
THE BLACK BOX DILEMMA

Concerns of Inventor:

1) What mechanisms and procedures to use in divulging the contents of the black box?
2) What restrictions to place on recipient with respect to his/her use of the information in the black box: if he/she elects to use the information, or if he/she decides not to use the information?
3) How long and how thoroughly to permit recipient to examine the contents of the black box?
4) How much to charge for a peek into the black box?

Concerns of the Recipient:

1) What restrictions on use of the information to accept, if he/she wants to purchase and use it?
2) What restrictions to accept on future use of the information, if he/she does not want to buy it?
3) What if the information is already in the public domain?
4) What if it turns out that he/she is already in possession of the information, or an important part of it?
5) How much to pay for a look into the black box?

LICENSING NEW INVENTIONS
THE BLACK BOX DILEMMA

A written (letter) agreement is safest way to preserve secrecy.

1) Area of technology defined with precision
2) Legal relationship of parties established
3) Purpose of disclosure documented
4) Solution of post-disclosure problems can be provided
5) Less chance of misunderstanding if terms spelled out
6) Agreement can be enforced by court according to basic contract principles

LICENSING NEW INVENTIONS
THE BLACK BOX DILEMMA

Critical clauses in secrecy agreement:

- limits on duration of secrecy obligation
  - no open-endedness!
- exceptions to secrecy obligation:
  1) already known to Recipient
  2) later comes into possession of Recipient through a third party without secrecy obligation to Inventor
  3) already in public domain
  4) later becomes public knowledge other than through the fault of the Recipient
  5) permission to disclose is obtained from Inventor
- a confidential relationship is established
- proprietary information is furnished for evaluation only

LICENSING NEW INVENTIONS
THE BLACK BOX DILEMMA

In the absence of a secrecy agreement, enforcement is more complicated.

Resort to special theories

- — Idea law
- — Idea must be concrete and novel

1) Implied
2) Breach of confidence
3) Unjust enrichment
4) Misappropriation of trade secrets

CONFIDENTIAL DISCLOSURE AGREEMENT

THIS AGREEMENT, entered into this _____ day of _____, 1980, by and between UNIVERSITY PATENTS, INC., a Delaware corporation having a place of business at 537 Newtown Avenue, Norwalk, Connecticut 06852 (hereinafter referred to as "UPI"), and _____ _____, having a place of business at _____ _____ (hereinafter referred to as "COMPANY").

W I T N E S S E T H:

WHEREAS, HENRY FREISER and CHARLES MARTIN (the "Inventors"), members of the faculty of the UNIVERSITY OF ARIZONA (the "Institution"), have invented LARGE ORGANIC CATION SELECTIVE ELECTRODES (UA 471) (the "Invention"), which belongs to said Institution; and

WHEREAS, UPI as technology transfer manager for Institution has the right to disclose to others the Invention, supporting disclosure materials, and other written materials relating thereto, and prototypes and/or samples thereof (the "Technical Information") and has the right to license the Invention to others; and

WHEREAS, COMPANY wishes to review the Technical Information for the purposes of determining whether or not it is interested in acquiring a license and/or other rights from UPI which would

COMPANY to undertake further development and sales embodying the Invention.

NOW, THEREFORE, in consideration of the premises and covenants herein contained, the parties hereto agree as follows:

1. UPI shall disclose to COMPANY the Technical Information regarding the Invention.

2. Upon execution of this Agreement, a confidential relationship shall arise between UPI and COMPANY; and COMPANY agrees to hold in confidence all Technical Information disclosed to it by UPI and not to disclose such Technical Information to anyone except such of its employees as may be necessary and not to use such Technical Information for a purpose not covered by this Agreement, unless:

(a) Such Technical Information is a part of the public domain prior to the date first written hereinabove; or

(b) Such Technical Information becomes part of the public domain not due to some unauthorized act by or omission of COMPANY after this Agreement is executed; or

(c) COMPANY can demonstrate that it or an affiliate or subsidiary company of COMPANY independently developed knowledge of such Technical Information; or

(d) Such Technical Information is disclosed to COMPANY by a third party who has the right to make such disclosure; or

(e) Permission to disclose said Technical Information or to make use thereof is obtained by COMPANY from UPI in writing.

3. COMPANY shall use such efforts to preserve the confidentiality of the Technical Information disclosed as it would if the Technical Information had been developed by COMPANY.

4. It is understood and agreed that the Technical Information referred to hereunder shall be furnished to COMPANY for evaluation in order that COMPANY may determine its interest in developing products under an agreement to be negotiated with COMPANY and for no other purpose.

5. If it is determined by either party hereto that an agreement relative to the use of the Invention cannot be successfully negotiated, COMPANY shall return to UPI any and all written material and/or prototypes and/or samples furnished by UPI to COMPANY. The return of the material shall not affect the obligations of COMPANY to treat the Technical Information disclosed to COMPANY as confidential, and not to use such

Technical Information, which shall continue for a period of three (3) years from receipt of the information by COMPANY.

6. This Agreement shall be binding upon and inure to the benefit of the successors and assigns of the parties hereto, but neither of the parties hereto shall assign this Agreement without the prior written consent of the other party.

7. No modification or waiver of any of the provisions of this Agreement shall be valid unless in writing and signed by the parties hereto.

IN WITNESS WHEREOF, the parties have hereunto set their hands the day and year first above written.

UNIVERSITY PATENTS, INC.

WITNESS: Susan L. Boersen

By: Albert D. Lasker

Title: Counsel

COMPANY

WITNESS:

_____

By: _____

Title: _____

INTERNATIONAL LICENSING

A. Additional Incentives
   1. minimize risk and costs
   2. a national ramps up quickly
   3. test market by going overseas first
   4. can lead to joint venture or subsidiary
   5. tariffs prohibit exporting to many countries
   6. meet "working" requirement of patent laws

B. Additional Problems
   1. culture and environment
   2. fear of investing overseas
   3. controlled economies
   4. political instability
   5. nationalization
   6. changing tax laws
   7. prohibition on foreign investment
   8. currency regulation/restrictions
   9. limits to repatriation of profits
   10. distribution problems
   11. patent laws favor nationals

A. *A Comparison of Legal Traditions*

United States	*Japan*
Pluralist society	Homogeneous society
Political, religious, and social thought influenced by 18th Century England and France	Political, religious, and social thought influenced by ancient China and Korea
Common law heritage (England)	Civil law heritage (Germany, France)
Adversarial legal system	Inquisitorial legal system
Federal republic (federal and state governments have separate court systems and their own substantive law)	Unitary state (jurisdiction and choice of law issues are non-existent)
Principle of stare decisis (judicial precedent) important in the application of legal principles	Judicial precedent relatively unimportant (law is based upon civil codes and regulations)
Civil justice system most important dispute resolution process (litigious nature of society)	Little reference to the civil justice system to resolve disputes (reliance upon informal compromise or conciliation procedures)
Jury system	No jury system
Elaborate mechanisms for discovery	Limited discovery
Punitive damages	No punitive recovery
Role of lawyer critical in effective resolution of disputes; power to shape society through judicial decisions, legislation, regulation; important participant in business counselling and negotiation	Lawyer viewed as an unnecessary evil; essentially barristers; little involvement in business counseling or commercial negotiation; business executives conversant with commercial law

ON THE ROLE OF LAWYERS IN JAPANESE AND U.S. SOCIETIES

There is a great difference in the role lawyers play in Japanese and U.S. societies. This is important with respect to the role an American lawyer should play in Japan no matter what his mission is in Japan.

U.S. society is organized around its legal system which plays a central role. Law and politics are all important here. In the Japanese society law plays only a peripheral role. In fact Japan can function without law.

Reasons: Japanese society has been homogeneous for ages. There are deep-seated traditions. Tribal forces have prevailed over social forces of industrialization and modernization.

U.S. society is heterogeneous with a short history and significant immigration throughout its history. There are no cultural traditions - law and order is the glue that holds the society together.

What governs social relations in Japan is "giri" - natural standards of appropriate conduct and "ninjo" - correct feeling while acting in correct way.

Thus, Japanese act in accord with giri with appropriate ninjo and that's what's being Japanese is all about.

Japanese society is trusting, harmonious; we are suspicious, litigious.

Resort to law presupposes a total breakdown in social harmony and is virtually the equivalent of violence. Litigation is always a disgrace.

Thus, it's logical that the Japanese don't like lawyers. Lawyers have an image problem in Japan, to say the least. They are a sign of trouble and low on the totem pole. Lawyers must keep a low profile, as low as possible and preferably stay out of sight. (Incidentally, this is also true in certain European countries, especially in Switzerland.)

This is the reverse of their conduct in the U.S. where they have to be forceful, even aggressive and confrontational. There is no horse trading in Japan. American style hard bargaining produces suspicion and paranoia.

U.S. Lawyers didn't even get visas from Japan until about four years ago if their reason for traveling to Japan was to depose Japanese nationals or open law offices and start law practices.

KFJ/Ruh/2.23.90

DIVERGENCE

A. Differences in Patent Systems

First to invent	First to file
No exclusions	Many exclusions
Inequitable conduct	None
Best mode requirement	None
Grace periods	Absolute novelty
Bogus prior art	None
No prior user rights	Prior user rights
Reexamination	Opposition
Focus on inventor	Focus on invention
Focus on inventors' rights	Focus on public rights

Many differences in litigation

B. Differences in Trademark Systems

Emphasis on use	Emphasis on registration
No "famous marks" (Dilution)	Famous marks

C. Differences in Copyright Systems

Emphasis on work	Emphasis on author
Weak moral rights	Strong moral rights

D. Other Differences

Multiple protection	Single protection
No utility models	Utility models

PATENT SYSTEMS: DIVERGENCE

U.S.	Japan
Objective:	Objective:
Exclusive rights to inventors	Utilization by Industry
Offensive purpose	Defenses purpose
Inventor applicant	Company applicant
High filing costs	Low filing costs
First-to-invent system	First-to-file system
1-year grace period	Early filing
Jumbo cases	Many small applications
Publication on issuance	Very early publication
Shortest possible examination	Deferred examination
Broad claim scope	Narrow claim scope
No separate examination fees	High examination fees
Post-issuance re-examination	Pre-grant opposition
No compulsory licensing	Compulsory licensing
No prior-user rights	Prior-user rights
Maintenance not expensive	Very high maintenance fees
Long terms — extensions	Short terms — extensions
Easy, broad discovery — jury trials — Preliminary injunctions	Difficult to enforce
Severe damages — treble damages	Marginal remedies
Doctrine of equivalence	Literal narrow claims interpretation

INTERNATIONAL LICENSING

CULTURAL DIFFERENCES

Americans	Asians & Other
Signing a contract is "closing a deal"	Signing a contract is "opening a relationship"
"A deal is a deal"	A deal is not always a deal
"If you don't have it in writing, you don't have it"	"It does not matter what you have on paper"
Sanctity of contract	Essence of the deal is the relationship, subject to reasonable changes over time
An executed contract is a definitive set of rights and obligations strictly binding the two sides	The "deal" being negotiated is not the contract but the relationship between the parties
Preference for very detailed contracts to cover any and all contingencies	Preference for statement of general principles ("Heads of Agreement")
To solve problems, parties look to their written contract	To solve problems, parties look to their relationship

Article 00

The parties shall discuss and decide in good faith the detailed matters necessary to perform this Agreement or the matters not provided in this Agreement.

If a significant change in the business circumstances arises, the parties shall negotiate to change the terms and conditions of this Agreement to conform to such a change and the benefit of the parties.

PATENT SOLICITATION AND LICENSING IN JAPAN: THE HIDDEN DIFFERENCES*

*Karl F. Jorda***

It is a real pleasure and a distinct privilege to be up here once again and talk to you about Patent Solicitation and Licensing in the Land of the Rising Sun — but I do so with a twist. Over the past thirty years I have gained some insights into Japan for the most part through my Ciba-Geigy and my PIPA (Pacific Industrial Property Association) and LES (Licensing Executives Society) activities that are quite interesting. In particular, I'd like to discuss some hidden differences or some special syndromes that you should be aware of and keep in mind in setting out to do business or make a deal or solicit a patent in Japan. I'd like to do this in preference to nuts and bolts issues in drafting license agreements with Japanese partners or in prosecuting patent applications in the JPO (Japanese Patent Office).

Now before I go into these hidden differences or unique syndromes in greater detail, which I hope I'll be able to do without any bias on my part, let me mention that the first licensing experience I had in Japan was close to thirty years ago when it was still a bit uncommon. I mention it not to crow about involvement in licensing in Japan for several decades but because it was very very interesting for other reasons. It was a licensing-in situation for us where we, the Ciba-Geigy U.S. subsidiary, obtained a know-how and patent license from Musashino for the manufacture of cyanuric chloride by the catalytic trimerization of cyanogen chloride. American Cyanamic had a basic patent position which involved the use of charcoal as catalyst. Musashino improved upon it early on by developing a special activated carbon for this purpose. We got a ten-year royalty-bearing license, approved and blessed, of course, by MITI (Ministry of International Trade & Industry). After a lapse of ten years the license was to have been paid up. But, believe it or not, before the ten years ran out MITI came calling and insisted that Musashino had not been adequately remunerated and additional royalty payments would have to be made. We objected strenuously but ended up making one further sizable payment for a paid-up license. We believe that in those days MITI did this to other companies also and that other companies also gave in.

Now, of course, life is easier as MITI, formerly the inevitable third party to any license, is no longer involved. I remember an LES meeting in New York City around 1980 where a JETRO (Japan External Trade Organization) official, who was the luncheon speaker, announced with considerable fanfare that MITI controls were a thing of the past. Indeed, all that remains now is an FTC (Fair Trade Commission) antitrust review for any possible illegal clauses. I understand that only about ten percent of the agreements are found objectionable nowadays and have to be revised and where there is an objection the matter can be settled informally.

* Presented at the Twenty-fourth Spring Meeting of the Patent and Trademark Institute of Canada, March 7, 1990.

** © Karl F. Jorda, Franklin Pierce Law Center, Concord, New Hampshire, USA.

Now on to the three special uniquely Japanese syndromes which I call the Black Ships, the Totem Pole and the Black Hole syndromes. But believe me, I did not make these up. I am not trying to be funny. They are as real as anything.

First, the Black Ships syndrome — When IBM moved its Far Eastern headquarters plus 200 families to Tokyo in 1984, the Japanese press made some ado about the "Black Ships" having arrived again. This is a reference to Commodore Perry's sailing into Tokyo harbor in black ships in 1854. It is still an expression in the Japanese language and it simply means that foreigners, i.e., Americans, have come to exert pressure on Japan.

When a PIPA delegation of 23 chief or international patent counsel, which I was privileged to head up because I was the President of PIPA at the time, arrived in Tokyo also in 1984 for a five-day meeting with the JPO, the "Black Ships" issue came up immediately. We attended this conference which the JPO termed "International Conference of the Patent Leaders Teams of U.S. Firms and the Japanese Patent Office" upon invitation by Mr. Wakasugi, the then Director-General, because the question had been raised as to whether the JPO was completely impartial *vis-à-vis* foreign applicants and Mr. Wakasugi wanted to prove to us on a "seeing is believing" basis that there was no discrimination. (Of course, we never thought there was any discrimination but that any problems encountered with Japanese patent practice were due to language and cultural differences and a lack of effort to learn the system.)

This conference was an historic event and an unprecedented first opening of the JPO and its inner workings to the foreign patent world. In his opening remarks Mr. Saida, the Engineer General, used the "Black Ships" analogy and waived a list of "60 complaints" that he expected us to voice. This list was based on surveys among Japanese patent examiners and Tokyo patent agents representing participating companies. However, Mr. Saida allowed as how we were "Gray Ships" inasmuch as we had been invited. After we had broached only five problems during the conference, Mr. Saida became quite conciliatory and friendly which was very clear from his keynote speech on the last day. No doubt, we had accomplished more by a low key approach than by barging in like Black Ships.

Now, what is the Totem Pole syndrome all about?

Have you noticed a certain reluctance on the part of your Japanese associates or representatives in Japan to deal with government agencies face to face? Did you ever wish they would be somewhat more aggressive? There is a "lack of aggressive Japanese patent attorneys in many cases".[1] This is apparently based on vestiges of the caste system which is still in existence in Japan albeit a bit under the surface.

It came as quite a revelation to us when we learned at an American Embassy breakfast meeting in Tokyo during that "International Conference" in 1984 that, e.g., patent examiners are as government/MITI officials, apparently considerably higher on the "totem pole" in Japanese society than lawyers, patent agents or practitioners. In fact, immediately before the 1984 Tokyo Conference I was asked by some of our Japanese associates "to help them help us" *vis-à-vis* the JPO — a phrase which I didn't fully understand at first.

On the subject of Japanese lawyers and associates or agents, let me put it this way: while we need them more than in any other country because of the language barrier, we can't rely on them completely. For American tastes, they are indeed not aggressive and confrontational enough — and can't be expected to be. As a rule, they are even reluctant to face up to examiners and hold interviews. Why? Because of the Totem Pole syndrome and by bringing this out I do not mean to denigrate them at all. On the contrary! They are very competent and dedicated professionals.

It is of course not possible for obvious reasons to hold interviews in the JPO without one's Japanese associates or agents but it is advisable to use them more as facilitators and interpreters than as advocates. They don't seem to mind if the U.S. practitioner plays the role of the advocate.

> Developing strategy for Japan is your job. No one is going to help you. Your agent will give you advice but only if you have thought out beforehand what questions to ask. So, largely what happens in Japan is under your control. . . .(T)he point to remember is to use the Japanese rules to your advantage. In other words, join the game. Do not simply sit back and complain.[2]

To come back to interviews — even before the 1984 Conference, Mr. Wakasugi had made a ringing "formal declaration" at the PIPA Congress in Washington in October 1983 that the JPO would henceforth be "open and transparent except for confidential material and receptive to all direct and indirect contacts". We considered that proclamation as a significant milestone.

The JPO had indeed stayed open and remained receptive and late in 1988 in another JPO/PIPA meeting, the fourth in the continuing series, the present JPO Commissioner, Mr. Yoshida, and other JPO officials, reiterated and reconfirmed that the JPO is "open to all problems, all people, at all times" and that they want to make their patent system more "user friendly". Based on my experience and involvement, it is my opinion that these statements are not just empty words. I for one believe that they mean what they say. In this connection JPO officials, however, always cautioned us of this "presupposed familiarity with the Japanese system" on the part of foreigners dealing with the JPO.

In fact, we have a standing invitation from the JPO to drop in any time for interviews with examiners or chats with JPO officials. I have done so and so have other U.S. practitioners, corporate as well as private. I am sure it was as rewarding and fruitful an experience to other U.S. practitioners as it was to me.

In one case, for example, I held a successful interview with several JPO officials in a difficult administrative appeal case which involved a grace period issue in a PCT application.

In this regard, Alexander P. DeAngelis, head of the National Science Foundation's Tokyo office, said

> Too much . . . is made of the (cultural) differences or the special knowledge that's needed. I find officials there are very accessible and very open. It's easy to call up an agency and say I'd like to come up and talk. There's not a lot of protocol.[3]

Precisely! I couldn't agree more! This confirmed my experience and helps to demystify the notion that everything in Japan is formal and the Japanese are inscrutable and this shows that what I said about the JPO also goes for other governmental agencies in Tokyo.

Interviews with JPO examiners, previously rare or unavailable, are now rather standard practice. This is a very significant liberalization, since it can be very helpful in any country to interview a patent examiner to clarify and advance patentability issues and this is especially true in Japan where office actions were often rather brief if not cryptic.

Now a few words about the Black Hole syndrome — In his fascinating book *The Reckoning* which relates the histories of the Nissan and Ford Motor Companies, David Halberstam has a special "Author's Note" at the end in which he describes that it was relatively easy to do research for his book in Detroit but that the

> Japanese section was harder to do, not because of language problems but because the Japanese have a very different attitude toward divulging what they know.

He refers to the Japanese intellectual, Tadao Umesao, as having pointed out that in

> terms of communications Japan is like the Black Hole of the universe: It receives signals but does not emit them (since) the getting of information has a positive social value while the giving of it is considered worthless or even harmful.[4] (emphasis added)

Through PIPA we feel that we have been able to neutralize the Black Hole quite a bit. At PIPA Congresses the Japanese group members often deliver excellent papers on various aspects of intellectual property law and practice in Japan. On several occasions we suggested that these papers be published for the edification of the IP community and as valuable source materials on Japanese intellectual property law and practice. However, the Japanese group leadership always demurred saying that these papers were only for the PIPA family. We could never quite understand why they took this position but the Black Hole syndrome appears to explain it adequately.

Another for instance, in licensing situations it's been noted that the Japanese partners always resist auditing provisions which are standard or even boiler plate for us. Japanese licensees would rather pay sizable lump sums or other fixed periodic payments to avoid auditing provisions and this can also be explained by reference to the Black Hole syndrome.

This ties in with the motto "Silence is gold, eloquence is silver".[5] Great talkers don't fare well in Tokyo. Japanese don't express opinions in definite terms. The higher the rank the vaguer their expressions. They try to avoid definite commitments even in negotiations. Americans, on the other hand, are excited and proud over technical achievements and disclose everything gladly and freely, even impulsively. The Japanese hold back. As one Japanese manager noted,

> We don't feel any need to reveal what we know. It's not an issue of pride with us. We're glad to sit and listen. If we're patient we usually learn what we want to know.[6]

In other words, the Japanese are reluctant to "open the kimono" or, as we would say, they "play it close to the vest".

As regards the silence-is-gold motto, you may have heard the story about three U.S. businessmen going to Japan to sell tractors. They made a great presentation at a Japanese company including pricing. There was no reaction on the part of the Japanese. The Americans got nervous and lowered the price. The Japanese kept quiet. The Americans again lowered the price way beyond their plan. They didn't realize that silence did not equate rejection. The Japanese were just quietly thinking it over.[7]

In this regard, there is the story of another group of American businessmen sitting down for negotiation with Japanese one Monday morning. There is lot of small talk on the part of the Japanese. The Americans get impatient and the delegation head finally loses his patience, pounds the table and says "Let's get down to business, we have a plane to catch on Friday. We've got to have it all wrapped up by then".[8] Such behavior of course will get anybody off to a bad start.

Yet another story: a team of American businessmen gets so frustrated after ten days of what they considered "dilly-dallying" and "stalling" on the part of the Japanese counterparts that they packed up and left in a huff just at the point when, according to the Japanese, everything was going swimmingly according to plan and the deal could have been wrapped up in short order.

This is where relationships, friendships come in in a big way. If you've never met your Japanese counterparts, it'll take a week or two of socializing and fraternizing till you can sit down for serious negotiations and, as Kou Kunieda calls it, "heart-to-heart communications".[9]

The lesson to be learned: Patience is important. What's to be kept in mind also is that the Japanese have a different concept of time. Japan has a polychronic culture which is discussed in great detail in the book *The Hidden Differences*.[10]

Just to summarize briefly, in polychronic cultures such as in the Mediterranean and the Japanese cultures, there is simultaneous occurrence of many things, great involvement with people, more emphasis on completing human transactions than on holding on to schedule. This contrasts with the North American and Northern European pattern of linear monochronic time where schedules become sacred. Japanese-style consensus building is clearly polychronic, although *vis-à-vis* foreigners, however, the Japanese can appear quite monochronic.

What should also be kept in mind on a mission to Japan is that there is a great difference in the legal systems and in the role lawyers play in Japanese and U.S. societies.[11]

U.S. society is organized around its legal system which plays a central role. Law and politics are all important here. In the Japanese society law plays only a peripheral role. In fact, Japan can function without law. Why?

The Japanese society has been homogeneous for ages. There are deep-seated traditions and social conventions. Tribal forces have prevailed to this day over social forces of industrialization and modernization. What governs social relations in Japan is "giri" — natural standards of appropriate conduct — and "ninjo" — correct feeling while acting in a correct way. Thus, Japanese act in accord with giri with appropriate ninjo and that's what being Japanese is all about.

U.S. society on the other hand is heterogeneous with a short history and significant immigration throughout its history. There are no cultural traditions — law and order is the glue that holds the society together.

Japanese society is trusting, harmonious; Americans are suspicious, litigious. There is no horse trading in Japan. American style hard bargaining produces suspicion and paranoia.

In Japan, resort to law presupposes a total breakdown in social harmony and is virtually the equivalent of violence. Litigation is always a disgrace.

Thus, it's logical that the Japanese don't like lawyers. Lawyers have an image problem in Japan, to say the least. They are a sign of trouble and low on the totem pole. Lawyers must keep a low profile, as low as possible and preferably stay out of sight. (Incidentally, this is also true in certain European countries, especially in Switzerland.)

Keeping a low profile is the reverse of the conduct of lawyers in the U.S. where they have to be forceful, even aggressive and confrontational.

In this regard, Halberstam has an interesting passage about Katayama, a Nissan Chairman in the sixties, and his reaction to lawsuits.

> The only thing about America he really did not understand and truly hated and feared was lawsuits. When even a minor suit was filed, he began to shiver. Suitcases, he called them, because his lawyer was always talking about the suit and the case. 'You have to save me from these suitcases', he would say. 'They want to kill me with them.'[12]

Your objective in Japan must be not to write tighter legal agreements but rather to establish better personal and business relationships. I, for one, am impressed with terse agreements like you encounter in Japan, Switzerland and some other countries. There is merit in such agreements and they work and the proof of the pudding is that they have been successfully used in these countries for a long time. The American rule if you don't have it in writing, you don't have it, is clearly incongruous with Japanese practice — a verbal agreement is just as binding.

Incidentally, what I said about Japan goes for Korea as well.

In Korea, the pragmatic and contractual terms of an agreement are generally less significant than the process. Human relationships based on mutual trust and benefit are far more important than a detailed contract. Contracts should be simple and as free from detail as possible. Koreans dislike lawyers, contracts which indicate a lack of trust, contracts which, through complex legal formulas, limit flexibility, and contracts full of details.

One should not try to rush into a contract, but allow the Korean side ample time for their collective decision making process to work. Westerners, particularly Americans, are very direct and like to get right to the point but Koreans are conversely vague. Patience and dignity and not pushing any issue too hard are very important. Western self-confidence and assuredness are often perceived as arrogance.[13]

In conclusion, let me wish you good hunting in Japan (and Korea) whether it be patents or licenses but please keep in mind the Black Ships, Totem Pole and Black Hole syndromes.

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TECHNOLOGY LICENSING: ROYALTY SETTING

It will hardly come as news that we also have a new ball game in the field of intellectual property (IP) licensing and technology transfer. Years ago there was little or none of that. All product innovation had to be home-grown technology and the NIH (not invented here) factor played a big role. And, of course, there is often an innate reluctance to license because it is more rewarding by far to have an exclusive patent position on an invention and exploit and self-commercialize it than to license it out. Also there is the concern that licensing will set up a competitor.

Dupont, Westinghouse and others until just a few years ago never licensed in nor licensed out. CIBA-GEIGY didn't do so. When they were developing a product and a patent issued to a third party that had priority so that they were not going to have a patent position, they just scuttled the project. They did not even bother to inquire about the availability of a license. And licensing out — perish the thought!

Nowadays even a simple, straight-forward plain-vanilla patent, knowhow or trademark license is practically a thing of the past; instead, complex and sophisticated hybrid agreements, option/license agreements; joint venture, corporate partnering, co-promotion or co-marketing arrangements; strategic alliances and consortium licensing are the order of the day.

And there are other very significant developments and trends in licensing attitudes and practices, in IP valuation and royalty setting or other quid pro quo choices, such as, e.g. cross licenses. And we have an entirely different antitrust climate where restrictions commonly found in license agreements are generally viewed as pro-competitive rather than anti-competitive and IP is considered property — as it should be — rather than a monopoly.

Well, this new climate, this new respect for IP, and the higher value of IP, does lead to new or greater incentives for R&D and other innovative activities because you know you can protect your IP and patent your inventions and the patents are going to stand up. The patents are going to be more valuable and we know that the patent system is a tremendous incentive to R&D and investments. Incidentally, according to the late CAFC Judge Rich, the patent system provides four incentives, namely, to invent, to disclose, to "invent around" and to invest and it is the incentive to invest, which is the most important one.

Conventional wisdom has it that the ratio of requisite investment in the three phases of product innovation from laboratory to market place, namely, invention, development and commercialization is supposed to be of the order of 1:100:1000, and this would support the thesis of investment incentive.

And of course, licensing, technology transfers and investments are ever so much easier to carry out and accomplish via patents and other IPRs as vehicles or bases. Indeed,

licensing is a very effective and civilized way of forming business relationships and transferring technology and by far preferable to infringement litigation, which is very much on the increase.

However, one attorney of a big New York law firm used to go around the country, giving talks at association meetings, particularly at meetings of the Licensing Executives Society (LES), on guess what topic? You won't believe this. It is "Patent Litigation and Trials: The Alternative to Licensing". Note he meant not just starting a lawsuit and then perhaps settling it but actually going through a knock-down, drag-out fight to the end in the courts. You have to understand he is with a big antitrust law firm whose business dried up when the Antitrust Division of the Justice Department went to sleep in the '80's. This forced antitrust lawyers to switch to IP litigation. And you thought licensing was the alternative to litigation because nobody wins in litigation except the lawyers, as they say.

This new climate has also lead to higher quid pro quos and royalties. Clearly the stakes have gone up. In fact, there has been a lot of hype and hoopla about value extraction and monetization of IPRs. ~~A dose of realism~~ is therefore in order.

Contrary to common assumptions, it is not true that licensors can charge what the traffic will bear, licensors can recoup their R&D expenses, the cost of the development of a technology is a big factor, etc. Indeed, there is a limit to what a licensor can charge and most often it is the licensee's economics, not the licensor's, that controls the royalty determination. And isn't there a 25/75% rule? Isn't licensee entitled to the lion's share because of the greater risk he/she carries, especially with less-than-fully developed technology? And above all, when it comes to royalties less is more and greed never pays off. In my corporate experience, several agreements turned sour because the royalties were too high, the profitability was not there and the deals could not be sustained in the end. On several other occasions, agreements had to be renegotiated for lower royalties for the same reasons. In other words, they were not viable win/win license agreements to begin with.

Actually, the cost to licensor of the development of the technology is not a factor at all. The R& D costs of developing the technology are sunken expenses expended by the patentee/licensor whether or not it is licensed and, therefore, should not be considered in arriving at a suitable royalty. That is to say, the public's interest in buying a product is essentially unrelated to the cost of developing it.

Furthermore, we should not lose sight of Tom Arnold's "100 Factors Involved in Pricing the Technology License," tabulated and discussed in the "1988 Licensing Law Handbook." This is a handy checklist, even though not all factors play a role in a given technology license. Among the most important and weighty factors are: a) the stage of development of the subject technology (embryonic, early stage and untested v. tested and commercial); b) the strength of the IPRs (solid v. weak, easy to design around *vel non*); and c) the degree of exclusivity (exclusive v. non-exclusive).

And the fact that many operative clauses in a technology license have economic weight, as for example, payment structures and schedules, most-favored-licensee clauses, representations and warranties, etc. needs to be kept in mind, so that royalty setting is not the first task in licensing negotiations but the last one, one to be tackled only after all the terms have fallen into place.

In IP licensing and especially patent licensing trade secrets cannot be ignored. Over 90% of all new technology is covered by trade secrets and over 80% of all license and technology transfer agreements cover proprietary know-how, i.e. trade secrets, or constitute hybrid agreements relating to patents and trade secrets.

As a practical matter, licenses under patents without access to associated, collateral know-how are often not enough to use patented technology, because patents rarely disclose the ultimate scaled-up commercial embodiments of products and processes. According to Homer Blair, "in many cases, particularly in chemical technology, the know-how is the most important part of a technology transfer agreement." And Robert Ebish advises: "Acquire not just the patents but the rights to the know-how. Access to experts and records, lab notebooks, and reports on pilot-scale operations, including data on markets and potential users of the technology are crucial." This is good advice because very few patents cover fully developed technology and hence are easily licensable. Moreover, according to Melvin Jager, "Trade secrets are a component of almost every technology license...(and) can increase the value of a license...up to 3 to 10 times the value of the deal if no trade secrets are involved."