12 Study on the Utilization of Intellectual Property Rights in a Business Group

With such developments as the 1997 amendment of the Anti-Monopoly Law, business restructuring has been accelerating in the industrial world, and more companies have changed their form to business groups consisting of a parent company (holding company) and operating subsidiaries with separate legal entities. As a result, group companies have come to face the need to divide or transfer their jointly-owned intellectual property and to address various legal issues in utilizing such intellectual property.

This study has focused on the "allocation of the intellectual property management function" and the "ownership of the intellectual property rights" within a business group, and has particularly selected the "centrally-managed /centrally-owned model" and the "centrally-managed /individually-owned model." Then, investigation and analyses have been made on the measures available under the current legal system and the points to be improved in legal systems with regard to the following issues, which are expected to arise when a business group utilizes intellectual property rights: (i) compensation for employee's inventions made in operating subsidiaries; (ii) which company enforces the right and the method of enforcement; and (iii) the tax affairs related to the transfer of rights and licensing back within a business group. As a starting point for proposing an environment for Japanese business groups to enhance their competitiveness through the smooth utilization of their intellectual property rights, this study has also suggested the possibility of applying the trust system to the utilization of intellectual property rights.

I Extraction of Issues Related to the Utilization of Intellectual Property Rights in a Business Group

1 Modes of Intellectual Property Rights Management in a Business Group

This study has presented four kinds of models as the modes of intellectual property rights (IPR) management assumed to be employed in a business group. The IPR management models have been set up by focusing on the allocation of the IPR management function and the ownership of IPR within a business group. (Figure 1)

(1) Management Mode 1: IPR are both centrally managed and owned

This mode would facilitate the development of an optimum intellectual property (IP) strategy for the whole group. In addition, the parent company that has the management function is able to utilize the IPR for the benefit of the whole group at its own discretion. Further, this mode is also effective in terms of operational efficiency and human resources development.

(2) Management Mode 2: IPR are centrally managed but individually owned

Like Management Mode 1, this mode would also facilitates the development of an optimum IP strategy for the whole group and is effective in terms of operational efficiency and human resources development. Further, since the individual subsidiaries own their respective IPR, they are likely to autonomously recognize the importance of strategically developing IP and maintain their incentive.

(3) Management Mode 3: IPR are both individually managed and owned

This mode would be adopted when the respective subsidiaries are engaged in considerably different types of businesses from each other. In this mode, each subsidiary manages and utilizes its IP in a way that suits its circumstances.

(4) Management Mode 4: Combination of the "centralized" and "individual" modes

This mode combines Modes 1 and 3. It enables the development of IP strategies for the whole business group as well as allows each subsidiary to conduct optimum IP activities that suit its circumstances.

2 Issues in the Respective Management Modes

Since a business group consists of a parent company and subsidiaries with separate legal entities, the following issues in conducting IP activities of the whole group can be assumed in a chronological order. (Figure 2)

(1) Issues assumed when a single company is restructured into a business group

When restructuring a company into a parent company and its subsidiaries, the assets need to be transferred. The IPR are also transferred to the company managing them, so the tax affairs in handling them must be made clear.

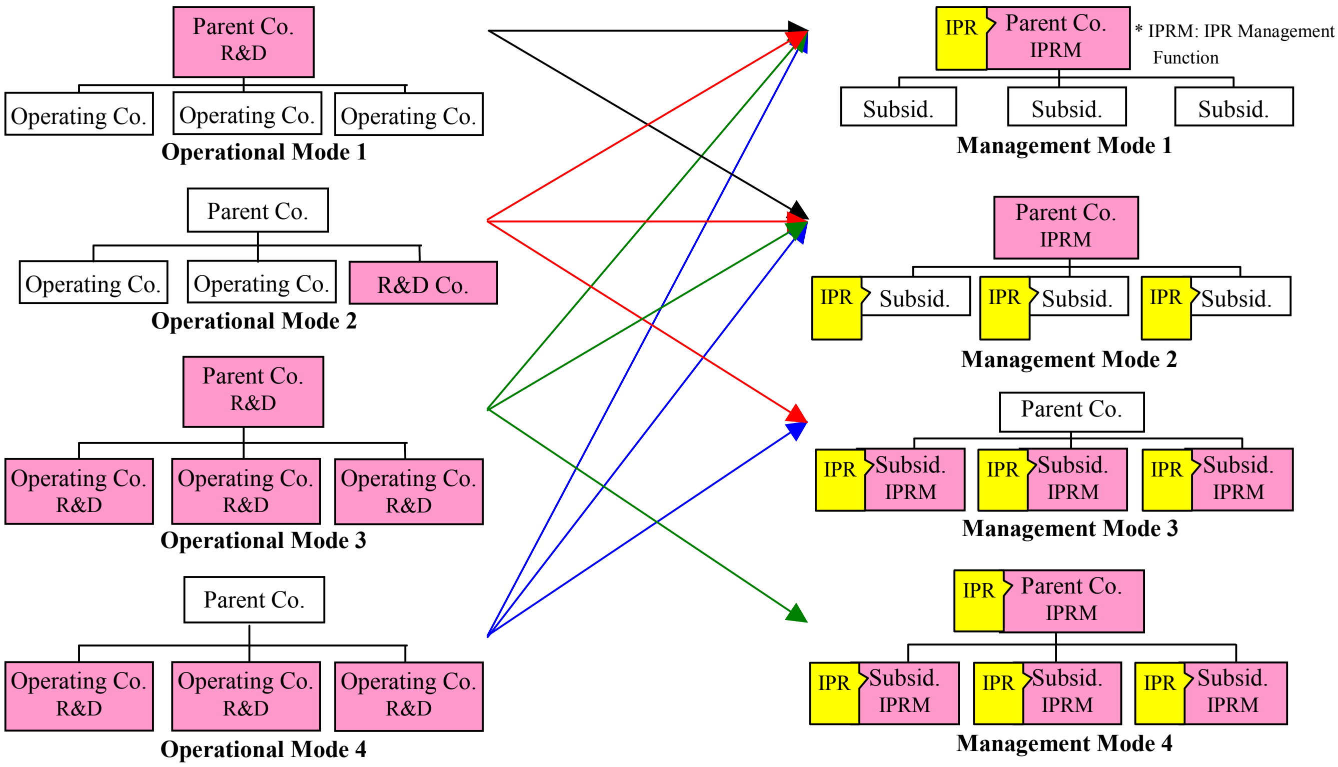

Figure 1: Location of the IPR Management Function and Ownership of IPR within a Business Group

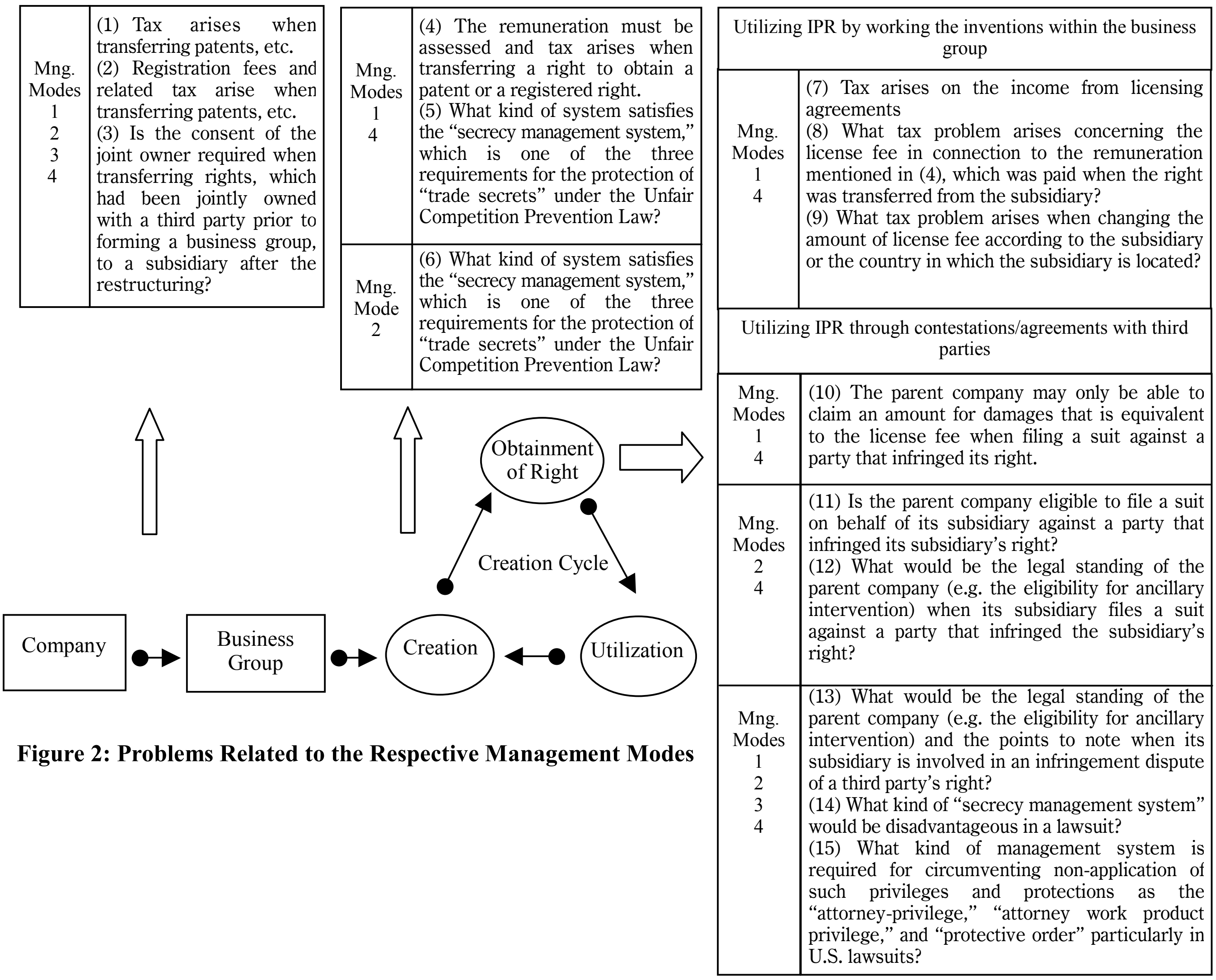

Figure 2: Problems Related to the Respective Management Modes

(2) Issues assumed in the phase of creating intellectual property

When implementing centralized management like Management Modes 1 and 4 in a business group after the restructuring, the rights to obtain patents need to be transferred between the parent company and the subsidiaries; so the tax affairs, as mentioned above, and the concept of legitimate compensation for employees' inventions in the subsidiaries must be made clear. At the same time, how the trade secrets and the like that would be exchanged between the parent company and the subsidiaries should be managed and its system must also be clarified.

(3) Issues assumed in the phase of utilizing the IPR

When utilizing IPR within a business group, licensing arrangement becomes necessary, and the tax affairs concerning the license fees must be made clear. In the case of enforcing an IPR on a third party, the parent company is only able to claim an amount of damages equivalent to the license fee from the infringer in Management Mode 1. In Management Mode 2, the parent company does not own the right, so its legal standing must be clarified. On the other hand, in the case of a third party enforcing its right on the business group, the legal standing of the parent company must be examined with respect to all of the management modes. The above items can be categorized as follows according to their nature:

(i) the issue of compensation for employees' inventions in the operating subsidiaries under the centralized IP management modes;

(ii) the eligibility to become a party with respect to enforcement;

(iii) the issue of the practice concerning secrecy management; and

(iv) the issue of tax concerning transfers of rights and licensing back within the business group.

While Management Modes 1 and 2 have some common issues, they have different issues as well. In Management Mode 3 where the individual subsidiaries manage the IPR independently, distinctive issues cannot be found in contrast to the conventional corporate form. Further, Management Mode 4 combines Management Modes 1 and 3, so it shares the same issues as Management Mode 1. Therefore, this study has focused on Management Modes 1 and 2 to discuss the concrete contents of the above issues from (i) to (iv) and summarized the measures available under the current legal system. In addition, investigation has also been made on the IP management modes of U.S. companies, which are likely to be utilizing IPR more freely and smoothly, as well as the related legal systems in order to clarify their actual conditions.

Ⅱ Issues Related to Compensation for Employees' Inventions Made in Operating Subsidiaries Ⅱ

1 Definition of the Problem

The assumable modes of utilizing IPR in Management Mode 1 are: (A) working of the inventions by the respective subsidiaries; (B) working of the inventions within the business group; and (C) working of the inventions outside the business group. In some of these modes, the subsidiaries cannot obtain monetary profits other than the compensation that the parent company has paid for the transfer of the rights (e.g. Modes (B) and (C)). However, in the actual transfer of an IPR from the subsidiary to the parent company, the amount of compensation paid for the transfer is often around the same as the amount necessary for obtaining the right (application costs) or even free; and the amount of compensation for the transfer of the right to obtain a patent from a subsidiary to its parent company is also expected to be low. Thus, in Management Mode 1, the subsidiaries may not be able to obtain profits from the utilization of the rights. However, this means that the subsidiaries cannot gain the funds for paying the due "reasonable remuneration" (Section 35 of the Patent Law) to the inventors, so how this remuneration should be paid presents a problem.

2 Measures: Two Approaches to Paying the "Reasonable Remuneration"

The following two approaches can be considered as the methods for paying the "reasonable remuneration" to the inventor who is employed by the subsidiary.

(1) Payment of "Reasonable Remuneration" by Subsidiaries

If the subsidiary is to pay the "reasonable remuneration," it must secure the fund for the payment, and the only fund available in such a case is the compensation paid by the parent company for the transfer of the right to obtain a patent. Therefore, the amount of compensation for the transfer must be decided by taking into consideration the result of utilization of the right, that is, the profits the parent company gains from the right. Two methods can be considered for the payment of such compensation.

(i) Lump-sum payment upon the transfer

The "reasonable remuneration" is calculated at the time of the transfer based on the various elements assumable at the time, and the amount of compensation for the transfer that has been decided based on that remuneration is paid in a lump sum to the subsidiary. In this case, the "reasonable remuneration" paid by the subsidiary to the inventor would also be in a lump sum.

(ii) Result-based compensation analogy

The compensation for the transfer is not paid in a lump sum at the time of the transfer, but is paid in installments by deciding the amount according to the result of the utilization of the right. This applies the general method of paying the remuneration to the inventor under the provision on employees' inventions (a filing-based remuneration, registration-based remuneration, or result-based remuneration) to the payment of compensation for the transfer. In this case, the "reasonable remuneration" paid by the subsidiary to the inventor would also be in installments. Under the method in the above (i), the value of the right to obtain a patent (the invention) must be calculated on a monetary basis upon the transfer, but it is actually difficult to calculate such an amount by foreseeing the progress of technological development and the changes of economic conditions that would take place by the time the invention would be patented at a time when the invention has merely been completed. Accordingly, the method in the above (ii) is considered to be more practical.

(2) Payment of "reasonable remuneration" by The Parent Company

The parent company or the like calculates the "reasonable remuneration" according to the result of its utilization of the right, and directly pays the amount to the inventor in its subsidiary. This method applies the current payment method for the "reasonable remuneration" paid by a company to its employee inventor, as is, to the relationship between the parent company and the inventor. As mentioned above, however, the parent company takes over the payment obligation of its subsidiary that has succeeded to its former operations in this case, so a right of indemnification arises on the part of the parent company under law. Considering that a tax problem occurs when abandoning the right of indemnification, it is considered difficult to adopt this method in reality.

Ⅲ Issues Related to Who in Business Group and How to Enforcethe Right

1 Problems Posed

(i) When Operating Company A transfers the patent for its invention to the parent company to have the parent company manage the patent (Management Mode 1)

In Management Mode 1, the patent right belongs to the parent company. When an infringement issue arises with regard to this patent right, the parent company owning the right can claim the patent as its own right and enforce the right in the judicial proceedings, since it is a justifiable act of filing or being filed a suit concerning its own right. That is a general form of litigation and does not have any particular problem under procedural law. On the other hand, when a subsidiary enforces a right jointly with the parent company or when an operating subsidiary, which does not own the right but is given the permission to work the patent, becomes involved in litigation, there will be a problem under procedural law pertaining to IPR management within a business group.

① Institution of a joint action and intervention in litigation

The following problems can be posed: (a) whether or not an operating subsidiary can become a joint plaintiff from the beginning when its parent company institutes an infringement action as a plaintiff; and (b) whether or not an operating subsidiary can intervene in an infringement action that has been instituted by its parent company.(*1)

② Intervention in litigation and taking over of litigation by the parent company

The following problems can be posed when an operating subsidiary, which had been working an invention within the scope of a license obtained from its parent company, is suddenly sued for alleged infringement of a third party's right: (a) whether or not the parent company can intervene in the litigation; and (b) whether or not the parent company can take over the litigation on behalf of the subsidiary as a defendant.

(ii) When the patent right for an operating subsidiary's invention is jointly owned by the subsidiary and the parent company

Another assumable mode of maintaining an IPR within a business group is where a subsidiary that "created" and "works" the invention and the parent company managing the right for the invention "jointly own" the IPR. In this case, the following problems can be posed.

① Whether or not the parent company can jointly institute an infringement action with the subsidiary

The first problem is whether or not the parent company can jointly institute an infringement action with the subsidiary. The assumable modes of infringement actions in this case are: (a) an action seeking confirmation of the patent right (infringement); (b) an action seeking an injunction

(*1) Another important point to be noted when reviewing these problems is the distinction of whether the right granted to the operating subsidiary by the parent company owning the patent is: (a) an exclusive license; (b) a monopolistic non-exclusive license; (c) a non-monopolistic non-exclusive license; or (d) without license.

and (c) an action claiming for damages, as an action to enforce a right.[*2]

② Whether or not the parent company can independently institute an infringement action

The second problem is whether or not the parent company jointly owning the right can independently institute an infringement action. The parent company can justifiably institute an action in relation to its own right alone, that is, its own share of right, because that complies with the general style of taking judicial proceedings with respect to one's own right. Such institution of an action is possible for any kind of infringement action (i.e., (a) an action seeking confirmation; (b) an action seeking an injunction; or (c) an action claiming damages).[*3] However, a point to be noted in the IPR management of a whole business group, particularly in relation to the subsidiaries, is what kind of effect the result of an action independently instituted by the parent company has on its subsidiaries. This point needs to be examined from the viewpoint of procedural law.

③ Whether or not the parent company can also independently institute an infringement action in relation to the rights of its subsidiaries

Lastly, there is a problem of whether or not the parent company can also independently institute an infringement action in relation to the rights of its subsidiaries. This means conducting judicial proceedings on another party's right under its own name, so it involves the problem of admissibility of filing a representative suit as a conventional agent.

(iii) When the operating subsidiaries own their IPR and the parent company is not entitled to those rights (Management Mode 2)

① Whether or not the parent company can intervene in an infringement action instituted by its operating subsidiary

The first problem that can be posed is whether or not the parent company can intervene in an infringement action instituted by its operating subsidiary, which owns the IPR. The assumable modes of infringement actions in this case are again: (a) an action seeking confirmation of a patent right (infringement); (b) an action seeking an injunction; and (c) an action claiming damages. The sole point at issue with regard to the action would be whether or not the parent company has an interest in conducting ancillary intervention (Article 42 of the Code of Civil Procedure).

② Whether or not the parent company can institute an action in the place of its operating subsidiary

Next, there is the problem of whether or not the parent company can institute an action ((a) an action seeking confirmation of a patent right (infringement); (b) an action seeking an injunction; or (c) an action claiming damages) in the place of its operating subsidiary. Since this is a situation where the parent company, which is not entitled to the IPR, files a suit in the place of its operating subsidiary, which owns the IPR, it is a typical case of filing a representative suit as a conventional agent under substantive law. Discussions can be made on whether the relationship of forming a single business group corresponds to the "common interest" required for using the appointed party system, which is a legitimate way of filing a representative suit as a conventional agent, or corresponds to a case where the filing of such a representative suit is allowed.

③ Whether or not the parent company can conduct ancillary intervention when an action has been instituted against its operating subsidiary; whether or not the parent company can fully take over the action in the place of the operating subsidiary

It is also necessary to assume problems regarding the allowable conducts of the parent company as part of the management of the contested IPR when its subsidiary, which had been operating on the premise of owning that IPR, is attacked by enforcement by another party. The assumable means of intervention are ancillary intervention and the taking over of litigation.

④ Whether or not the parent company can intervene in the trial for invalidation that has been demanded on a patent right of its operating subsidiary

There is also a problem of whether or not the parent company can intervene in the trial for invalidation of a patent that has been demanded against its subsidiary.[*4] If the requirement of "having an interest" for becoming a demandant in a trial for the invalidation of a patent can be interpreted broadly to include the parent company of the business group to which the subsidiary

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(*2) For the kinds of infringement actions, see Yukio Nagasawa, "*Chiteki Zaisanken Shingai Soshou No Shurui* (Kinds of IPR Infringement Actions)," *<Shin> Saiban Jitsumu Taikei 4: Chiteki Zaisan Kankei Soshou Hou* (<New Edition> Outline of Judicial Practices 4: Intellectual Property Related Procedural Law), edited by Toshiaki Makino/Toshiki Iimura: p. 37 (Seirin Shoin, 2001). Preservative proceedings could also be taken in a combined manner. Kazuhiko Yoshida, "*Chiteki Zaisanken Ni Okeru Karishobun/Hozen No Hitsuyou* (Need for Provisional Dispositions and Preservative Measures for IPR)," *Hanrei Times* (The Law Times Report), No. 1062: p. 58 (2001).

(*3) Nobuhiro Nakayama, *Kougyou Shoyuuken Hou <Jou> Tokkyo Hou [Dai Ni Han Zouho Ban]* (Industrial Property Law <Vol. 1> Patent Law [Expanded Second Edition]): p. 303 et seq. (Koubundou, 2000).

(*4) If the right is jointly owned, the parent company becomes a joint defendant. Section 132 of the Patent Law.

(*5) See the Tokyo High Court decision of September 28, 1983, *Hanrei Jihou* (Court Decision Journal), No. 1105: p. 135.

(patentee) belongs[*5], the parent company may intervene (Section 148(1) of the Patent Law) in the invalidation trial as one of the "demandants" under Section 132 of the Patent Law.

2 Problems under Adjective Law

(i) Interest in seeking confirmation

An action for confirmation is an effective method of IPR management utilizing the court. However, the preliminary requirement for using the action for confirmation is whether or not the party has an interest in the confirmation. Generally, the eligibility of the subject matter of confirmation and the interest in immediately obtaining a final and conclusive decision are examined as interest in the confirmation under the Code of Civil Procedure. Recently, courts and scholars have tended to interpret this interest in the confirmation relatively broadly for the cases relating to the Code of Civil Procedure. They tend to find an interest in an action seeking confirmation of a question of fact or confirmation of future legal relations.[*6] Considering this point in relation to IP disputes, the following problems have been pointed out: if the subject matter of confirmation in an action for negative confirmation is merely a "fact," it probably should not be eligible as the subject matter; and if the alleged act of patent infringement conducted by the defendant belongs to the future legal relations, it should not be eligible as the subject matter either.

(ii) Intervention in an action

① The significance of ancillary intervention in IPR management

The possibility of the parent company conducting ancillary intervention for its subsidiary has been assumed in many of the problems posed earlier. In civil litigation, an ancillary intervener can freely conduct acts of procedure in almost the same way as a concerned party, unless the act conflicts with the act of procedure of the original party (Article 45 of the Code of Civil Procedure). Therefore, if the parent company in a business group can intervene as an ancillary intervener in all of the cases involving the IPR management within the group, it can attain the objective of conducting unified and centralized IPR management even without instituting or taking over an action in the place of the subsidiary.

② Discussion on the interest in the ancillary intervention

First of all, it must be made clear whether or not the parent company corresponds to "a third party interested in the result of a suit" (Article 42 of the Code of Civil Procedure) with regard to an action instituted by its subsidiary. That is the question of whether or not the parent company is found to have the interest in the ancillary intervention. The prevalent theory in recent years is to also allow ancillary intervention when the intervener receives a de facto influence from the determinations (main points at issue) in the reasons for the judgment. The recent trend of the practice seems to be to find an interest in the ancillary intervention in a quite flexible manner.

(iii) Representative action as a conventional agent

The issue of the acceptability of filing a representative action as a conventional agent is one of the traditional controversial points of the Code of Civil Procedure. As long as the parent company and its subsidiaries within a business group are separate legal entities and have a capacity to conduct juristic acts and procedural acts independently, the parent company would often have no other choice but to rely on the representative action as a conventional agent in order to manage the IPR of the subsidiaries through litigation.

① Discussion on the eligibility to become a party in a suit

In Management Mode 1, the parent company that owns the patent is justifiably eligible to become a party in all kinds of infringement actions concerning the patent. Further, even in Management Mode 1, the subsidiary is also eligible to become a party as long as it has an exclusive license for the patent. However, if the subsidiary only has a non-exclusive license for the patent, it is unable to seek an injunction or claim damages based on the patent under procedural law. In Management Mode 2, if the parent company institutes an infringement action in the place of its subsidiary, the parent company is not entitled to the right at all, so it also becomes subject to the issue of filing a representative suit as a conventional agent. When the IPR are jointly owned, the parent company and the subsidiaries could basically institute an infringement action under their own names or be instituted an infringement action only for their own shares of the rights.

② Acceptability of filing a representative suit as a conventional agent

The system of filing a representative suit as a conventional agent is where the right holder, who is basically the person eligible to become a party, authorizes a third party to carry out the legal proceedings under the third party's name at his/her own discretion (free intent). However, the legality of this system is generally not clear apart from such exceptions as the appointed party system. The present court decisions and academic theories take the same view to make the following the requirements for allowing the filing of a representative suit as a conventional agent: (a) the

(*6) Sadaichirou Nakano, "*Kakunin Soshou No Taishou* (Subject Matter of Actions for Confirmation)," *Minji Soshou Hou No Ronten II* (Controversial Points of the Code of Civil Procedure): p. 41 et seq. (Hanrei Times Co., 2001).

party has been authorized by the right holder (the person entitled to manage and dispose of the right) to carry out the legal proceedings; and (b) the conventional agent has an interest that does not circumvent the purports of the principle of representation by lawyers(*7) and the prohibition of entrusting a suit, which are restrictive regulations. If the exercise of another party's right in litigation is deemed to be a continuous duty carried out by gaining remunerations, it is necessary to take into consideration the prohibition of activities by non-lawyers (Article 72 of the Lawyers Law) and, in the case of IP-related cases, the prohibition of activities by non-patent-attorneys (Article 22 of the Patent Attorneys Law), as provisions prohibiting a representative action by a conventional agent.(*8)

Ⅳ Investigation of the Actual Conditions of the Centralized IPR Management Modes in U.S. Companies (IP Holding Companies)

The IPR management modes of U.S. companies that are considered to be using IPR freely and smoothly, as well as the related legal systems, have been investigated and analyzed as below. This study has also covered the requirements for establishing a holding company in Delaware (hereinafter "DHC"), the state tax privilege applicable to a DHC, the restrictions on the operations of a DHC deriving from state tax law and federal tax law, and the general legal problems pertaining to establishing an IP holding company (hereinafter "IPHC") and having it manage the IPR.

1 Delaware Holding Companies (DHC)

(1) Purpose of Establishment

The main purpose for establishing a DHC is to save state tax (tax avoidance).

(2) Mechanism of Tax Avoidance by a DHC

The tax system in the United States basically consists of federal tax law and state tax law. In other words, a taxpayer must pay taxes to both the federal government and the state government for the same piece of income.

(i) Delaware Tax Code 1902(b)(8)

The Delaware Tax Code 1902(b)(8) stipulates that a DHC is exempt from state tax. When a company established in Delaware meets this provision, it is recognized as a DHC and is exempted from all state taxes on its corporate income.

To that end, however, the activities of the company are "confined to the maintenance and management of intangible investments" within Delaware, as stated in Section 1902(b)(8). Delaware's tax authorities interpret "confined" very narrowly, so if the company has an income from any other activity, it cannot be exempted from the state tax.

(3) Transfer of IPR (Internal Revenue Code 351(a))

The IPR maintained and managed by a DHC are created by the parent company and are transferred to the DHC. According to Internal Revenue Code (I.R.C.) 351(a), the transfer is not deemed to have an economic effect if the IPR is exchanged for stock in DHC, and no gain or loss is recognized from the transfer. Specifically, even if property is transferred from one company to another company that is virtually under control of the former, no economic effect is deemed to have occurred in reality, similar to a case where property is transferred from one division to another within the same company. In this case, the DHC must be under control of the parent company.

(4) Licensing Back

After the IPR have been transferred, the DHC grants licenses for the transferred rights to the parent company, and the parent company pays license fees to the DHC for the licenses it has obtained. The license fees are calculated according to I.R.C. 482. A license fee in this case must be an "arm's-length rate," that is, it must be as close as possible to a licensee fee that results from formal transaction negotiations by deeming the parent company an unrelated third party.

(5) Tax Treatment of License Fees

The parent company can enjoy tax deduction for the license fees paid to the DHC by deeming them as necessary business expenses and the DHC can enjoy exemption from state tax for the license fees it has received.

(6) Return of Profits

The license fee income is used by the DHC as its operating funds. The profits earned by the DHC can be returned to the parent company in two ways. One is to return the profits to the parent company in the form of dividends, in which case the parent company can enjoy tax deduction for them under I.R.C. 243(a)(3) and does not need to pay the federal tax for them. The other way is to return the profits by extending loans to the parent company, in which case the parent company can deduct the loan interests, which it has paid, from its income. The interests would be an income for the DHC, but the

(*7) The fact that this provision is established for protecting the interest of the party rather than for a prohibitive purpose is explained in detail in Tetsuichirou Ueda, *Toujisha Byoudou Gensoku No Tenkai* (Development of the Principle of Equality of the Parties): p. 115 et seq. (Yuhikaku, 1997).

(*8) *Toukyou Daigaku Houritsu Purofesshonaru Seminaa* (Professional Seminar of Law, the University of Tokyo), *Mochikabu Gaisha No Riron To Jitsumu* (Theories and Practices of Holding Companies), *<Bessatsu> Shouji Houmu* (<Supplementary Volume> Commercial Legal Affairs), No. 231: p. 115 (2000).

interest income does not make the DHC lose its state tax deduction privilege, and the state tax on the interest income is deducted.

2 Establishment of an IPHC and Its Operations

(1) Conditions for the Establishment

In establishing an IPHC, one must first choose the state in which the IPHC will be established. Such a state is restricted to a state in which the IPHC will be exempted from state tax on its income (e.g. Delaware).

(i) Maintenance of the deduction privilege in the state in which the IPHC is established

In order to enjoy the privilege of state tax deduction, the IPHC must limit the scope of its operations within the scope specified by the tax code of the state. Meanwhile, if the services it has provided to the parent company are within the scope that is recognized as maintenance and management of IPR, the IPHC can claim compensation for the services from the parent company as well as be exempted from state tax on that income.

(ii) The relationship with the state in which the parent company is located (1)

The parent company is able to save state tax by establishing an IPHC, but it also means that the state tax revenue of the state in which the parent company is located will decrease. Therefore, the tax authorities of the state in which the parent company is located monitor for any illicit intent in establishing the IPHC, and if they find that the IPHC is a dummy company that has merely been established for the sake of saving state tax, they do not allow the parent company to enjoy tax deduction for the license fees.

(iii) The relationship with the state in which the parent company is located (2)

While the IPHC must exist in reality in the state in which it has been established, it must limit its operations as much as possible in the state in which the parent company is located. Generally, when a state imposes tax on a company that has been established in another state, the former state must have a relationship with that company. In principle, if a company has an office in the state, that state is allowed to impose the tax on the company.

3 Granting Licenses to the Parent Company

(1) Viewpoints in Relation to Tax Code

As mentioned above, an IPHC is established for the purpose of tax avoidance, so there is no sense in establishing an IPHC without a tax-saving effect. According to this purport, the licenses granted to the parent company should be non-exclusive, but as earlier-mentioned, a condition for establishing an IPHC is to have the IPHC operate as a substantive company. If it were found to have been established only for the purpose of tax avoidance, the parent company would not be allowed to enjoy the tax deduction for the license fees in the state in which it is located. Therefore, if the licenses granted to the parent company were exclusive, the IPHC's control over the parent company would be too strong, and it may be considered to have been established as an attachment to the parent company (for the purpose of tax avoidance).

(2) Viewpoints in Relation to the Patent Law

① Remedies for patent infringement

The remedies available for patent infringement are an injunction (including an injunction issued by the United States International Trade Commission) and a claim for damages; an IPHC can enjoy both of these remedies as a patentee. The damages can be compensated in the form of either lost profits or a reasonable royalty, and the patentee can choose either one. However, since the recovery of lost profits requires the patentee to have been actually working the patented invention, an IPHC cannot claim lost profits, but only a reasonable royalty, in an infringement action.

As discussed later on, a non-exclusive licensee lacks standing to sue for infringement, so the parent company cannot claim damages if its license is non-exclusive. Since an exclusive licensee generally has standing to sue, if the parent company has an exclusive license, it can institute a patent infringement action and claim lost profits.

② Reasonable royalty

A reasonable royalty is derived by assuming what would have been an agreeable license fee if a willing licensor and a willing licensee were to hold a hypothetical negotiation (a hypothetical license). The elements that must be considered in deciding the license fee have been defined by a court decision.[*9]

③ Standing to sue

Under the U.S. patent law, only the patentee or a person who has been assigned the patent from the patentee can file an infringement action. However, the "successor in title to the patentee" in 35 U.S.C. Section 100(d) is interpreted broadly, so when it is virtually the same as having transferred the patent right, the person can institute an infringement action without being a patentee. Such practice is sometimes applied to an exclusive licensee as well. Basically, a licensee cannot have standing to sue because a license is merely an agreement that the "patentee will not sue the licensee for working the invention." In order to have standing to sue, one must own the patent right.

(*9) Georgia Pacific Corp. v. United States Playwood Corp., 166 USPQ 235 (S.D. N.Y. 1970).

V The Possibility of Applying the Trust System to the Utilization of IPR

1 The Aspect of the Trust System as a Property Management System

The distinctive features of the trust system could be effectively understood by comparing the trust system with the representation system under the Civil Code. Trust property is given independence according to the purpose of the trust set by the trustor. The specific forms of independence under the principle of trust include: independence of the trustee from the trustor's right to order and right to cancel; exclusivity of the trustee's right of management of property, right of disposal, and right to impose an obligation; independence of the trust property from the trustee's individual creditor and inheritance; and limitation of the trustee's responsibilities arising from the act of management of property to the trust property. Such independence of the trust secures persistence and stability that allow long-term distribution of the profits from the trust property to the beneficiaries as well as the security in the case where a conflict of interests arises with regard to the management of the trust property. In addition, it makes it easier for one to seek a decision concerning the management of the trust property. At the same time, the trustee would also be able to manage the trust property outside the control of the trustor, so strict obligations are imposed on the trustee as a matter of course. The specific obligations are: the good manager's duty of due care in which one must process the trust affairs with due care of a good manager according to the true aim of the trust (Article 20 of the Trust Law); prohibition to make the trust property one's individual property (Article 22 of the Trust Law); obligation to manage the individual property and the trust property separately (Article 28 of the Trust Law); obligation to carry out the trust affairs on one's own (Article 26 of the Trust Law); and obligation to compensate for losses or recover the trust property upon breach of trust (Articles 27 and 29 of the Trust Law).

2 Intellectual Property and the Trust System

When considering use of the trust system for IP, it is necessary to pay attention to the conversion functions of the trust system. By effectively utilizing the trust system according to needs, IPR can have:

① a long-term management function;
② a collective management function;
③ a function to convert private-interest property into public-interest property; and
④ a bankruptcy remoteness function.

The significance of introducing the trust system in the IP management in a business group is in utilizing the conversion functions of the trust system. For instance, when a company owns an IPR, but does not have the know-how to make use of it, it can transfer the IPR to a trustee who has know-how of use in order to raise the value of the right. In addition, when an IPR is likely to be infringed, the IPR can be protected from infringement by using the trust system. Further, it may be possible to centralize dispersed IPR or disperse centralized IPR by using the trust system as the medium. There is also a method to secure the IPR of a nearly bankrupt company by using the bankruptcy remoteness function. All of the conversion functions of the trust system are applicable to IP, and new additional conversion functions could even be created according to the needs of the IP. In any case, it would be possible to replace the centralized and dispersed management methods that have been mentioned as the IPR management modes in a business group with ones based on the trust system.

VI Tax Problems and Measures Concerning Transfers of Rights and Licensing-Back Within a Business Group

1 Assessment of Patent Rights or the Like

The following methods can be considered for assessing patent rights or the like: (1) a cost approach; (2) an income approach; and (3) a market approach.

2 Transfer of Patents Between Domestic Companies upon Shifting the Structure of the Parent Company

(1) Compensation for the General Transfer of Patents between the Parent Company and its Subsidiaries or between the Subsidiaries

The amounts to be included in the gross revenue when calculating the income subject to corporate tax are basically the current values of the transferred assets. Regardless of whether the transfer was made between the parent company and its subsidiaries, between the subsidiaries, or with a third party, the compensation for the transfer must fundamentally be the current value under the Corporation Tax Law.

(2) Tax Problem when the Compensation for a Transfer is Inappropriate

When the compensation for the transfer of an asset is different from the current value of the transferred asset, the difference is basically treated as a contribution or a donation income.

(3) Taxation Related to the Transfer of Patents upon a Shift to a Holding Company

The possible methods of shifting to a holding company are by exchange of shares, transfer of shares, corporate separation, investment in kind, and subsequent incorporation. The taxation on the transfer of patents differs according to the method of establishing the affiliate relationship (the holding company).

(4) Consolidated Return System and the Transfer of Patents

"*Renketsu Nouzei Seido No Kihonteki Kangaekata* (Basic Concept of the Consolidated Return System)," released by the subcommittee on corporate taxes of the Tax Commission on October 9, 2001, outlines the consolidated return system as follows:

① the corporations to which the consolidated return system is applicable are the parent company (a domestic company) and its wholly-owned subsidiaries (domestic companies);

② the consolidated income amount is calculated for the consolidated group as a whole and the consolidated tax amount is calculated by deducting taxes from the amount obtained by multiplying the consolidated income amount by the tax rate;

③ transactions of assets between companies within a consolidated group are to be conducted based on the current values, and the profits and losses from such transfers of assets are chiefly deferred;

④ when the compensation paid for the transfer of an asset between companies within a consolidated group is different from the current value of the asset, the whole sum of the difference is to be treated as a nondeductible contribution;

⑤ when starting the application for the consolidated return system or adding a subsidiary to a consolidated return group, the valuation profit or loss concerning the assets of the consolidated or added subsidiary is to be added up except in certain cases; and

⑥ the consolidated surtax is to be adopted as a measure against lower tax revenues pertaining to the establishment of the consolidated return system.

3 Tax Treatment Concerning Utilization of Rights for Employees' Inventions of Operating Subsidiaries in Management Mode 1

(1) When the Invention is Commercialized by the Operating Subsidiary

(i) Taxation on the operating subsidiary

In principle, the royalty for the patent paid by the operating subsidiary to the parent company is included in the operating subsidiary's expenses on an accrual basis. The compensation for obtaining the license for the patent is depreciated in fixed installments over the shorter period of either eight years or the term of the license according to the patent right, both in the case of a non-exclusive license and an exclusive license.

(ii) Taxation on the parent company

In principle, the royalty for the patent that the parent company has received from the operating subsidiary is included in the parent company's gross revenue on an accrual basis. The compensation received by granting the license for the patent is chiefly added to the gross revenue in a lump sum in the fiscal year in which the license has been granted. When the current value of the patent royalty or the license is found to exceed the actual amount of patent royalty or the amount of compensation for the grant of license paid by the operating subsidiary, the portion of the excess amount that is recognized to have been donated in effect is treated as a donation to the operating subsidiary.

(2) When the Invention is Commercialized by Another Domestic Operating Subsidiary

(i) Taxation on the other domestic operating subsidiary

The taxation is the same as that on the operating subsidiary in (1) above.

(ii) Taxation on the parent company

The taxation is the same as that on the parent company in (1) above.

(3) When the Invention is Commercialized by a Third party

(i) Taxation on the third party

The taxation is the same as that on the operating subsidiary in (1) above, but the problem of donation does not occur in principle. This is because, the difference of opinions between the persons with conflicting interests can be adjusted through negotiation, and the value of the transaction is expected to be decided when the value comes to a level that is agreeable to both parties.

(ii) Taxation on the parent company

The taxation is the same as that on the parent company in (1) above, but the problem of donation does not occur in principle due to the above-mentioned reason.

(4) When the Invention is Commercialized by Multiple Operating Subsidiaries and Third Parties

When the operating subsidiaries and the third parties have obtained the license for the patent under different conditions, and the differences of the conditions are not reasonably accountable, the operating subsidiaries or the parent company would need to recognize the differences as donations.

4 Tax Treatment of the Damages or the Like Recovered by Patent Enforcement

(1) Taxation of the Damages

(i) Corporate tax

The recovered damages is included in the gross revenue.

(ii) Income tax

The recovered damages relating to patent infringement does not correspond to the damages relating to "mental or physical injury or damages to assets due to an unforeseen accident" under Article 9(1)(xvi) of the Income Tax Law. Therefore, the amount of the damages is deemed to be part of business income. The damages that has the nature of revenue is deemed to be a royalty.

(iii) Consumption tax

The damages relating to patent infringement corresponds to the transfer of assets.

(2) When the Right is Jointly Owned by the Parent Company and the Subsidiary or by Multiple Operating Subsidiaries

The recovered damages would be distributed and the damages to be paid would be borne generally in proportion to the respective shares of the jointly owned right. However, the distribution or bearing according to a reasonable rule that has been agreed upon in advance by the joint owners would also be acceptable in respect to tax.

(3) When the Damages was Recovered in an Operating Subsidiary's Litigation that Has Been Represented by the Parent Company

When the damages was recovered in an operating subsidiary's litigation that has been represented by the parent company, the damages externally belongs to the subsidiary (principal). However, if the substantial ownership of the right does not fully belong to the operating subsidiary due to a reasonable agreement in advance, the recovered damages is deemed to belong to the subsidiary according to its substantial share of ownership of the right also in terms of tax.

5 Tax Treatment in Utilizing the Trust System for Patents

According to the principle of taxation on a real income earner, a trust asset is deemed to be owned by the beneficiaries, and any income or expense concerning the trust asset is basically treated as belonging to the beneficiaries in respect to tax. The tax law stipulates that revenues arising from assets or businesses are treated as belonging to the parties who benefit from them, and basically imposes tax by deeming that any income or expense related to a trust asset belongs to the beneficiaries. If an operating subsidiary's entrustment of patent rights to another company within the group causes no legal problems, it would be possible to eliminate tax problems concerning the transfer of patents within a business group.

The matters on tax treatment are dealt in a question-and-answer format in the report of this study.

Ⅶ Other Problems and Measures in Practice

1 Secrecy Management System within a Business Group

Should the parent company manage and utilize the IPR of the operating subsidiaries, the IPR management function of the parent company is assumed to be assigned such IPR as the right to obtain a patent from the operating subsidiaries, take the procedure for obtaining the patent or the like (such as filing applications), and utilize the rights based on the business strategy of the whole business group. By conducting these operations, the parent company would directly learn about the inventions, devices, and other trade secrets of the operating subsidiaries. On the other hand, the operating subsidiaries may also gain knowledge of the business strategy of the parent company or the business group, or the trade secrets of the parent company or other operating subsidiaries from the parent company. Therefore, problems may arise in how the system for managing the trade secrets of the parent company and the operating subsidiaries should be established. Specifically, the following three issues will be discussed here:

(1) whether or not the secrecy of a trade secret would be lost if an operating subsidiary disclosed the trade secret to the parent company or the parent company disclosed the trade secret to an operating subsidiary;

(2) whether or not there is a need to have separate patent attorneys' offices or patent attorneys take charge of such procedures as the filing of applications for the parent company and the operating subsidiaries from the viewpoint of the secrecy management of trade secrets; and

(3) whether or not the parent company is also eligible to seek an injunction or claim for damages when a trade secret of its subsidiary has been infringed.

The example cases of (1) are:

(i) where the parent company releases information that has been disclosed by its operating subsidiary to another operating subsidiary; and

(ii) where the result of joint development by the parent company and a third party is disclosed to its operating subsidiary.

One of the requirements for a "trade secret" under the Unfair Competition Prevention Law, that is, the requirement that the information must be "managed as a secret" (the requirement of being managed as a secret), specifically requires the following:

① a person who has accessed the information must be able to recognize that the information is a trade secret (e.g., "confidential," "strict secret," or "for internal use only");

② there must be a restriction on persons who have access to the information (e.g., take measures to disable access from outside the company, or require authorization to access the information). Even when disclosing the information to a third party by licensing or the like, as long as a confidentiality agreement is concluded and secrecy management is adequately conducted, the information is considered to meet ① and ② above, and continue to satisfy the requirement of being managed as a secret. Therefore, if such an indication as "confidential," "strict secret," or "for internal use only" is attached to the information, a confidentiality agreement is concluded, and such a management system as a physical access restriction is established, the information would continue to meet the requirement of being managed as a secret even in the cases of (i) and (ii) above.

With regard to the problem in (2), first, the patent attorney takes on a secrecy obligation to the client under the Patent Attorneys Law (Article 22). Then, even if the companies were a parent company and its subsidiary, the patent attorney has an obligation not to release a trade secret that has been disclosed from either one of them to the other, as long as the companies are separate legal entities. Therefore, from a legal point of view, there is no need to have separate patent attorneys' offices or patent attorneys for the parent company and the subsidiaries.

As for the problem in (3), first, the Unfair Competition Prevention Law provides for a person having the right to seek an injunction as "a person whose business interests are infringed or are likely to be infringed by unfair competition" (Article 3) and a person having the right to claim for damages as a third person whose "business interests have been infringed" (Article 4). A person whose "business interests have been infringed" is regarded to refer to a person who owns the information, including anyone who manages the information.(*10) Even if a trade secret were disclosed by such an agreement as licensing, a person possessing the authority to use or authority to disclose the information would be regarded to correspond to a person whose "business interests have been infringed." Therefore, the parent company would be eligible to claim for damages.

2 Possible Conflict of Centralized IPR Management with Article 72 of the Practicing Attorney Law

(1) Modes of Involvement of the Parent Company

The assumable modes of the parent company's involvement in utilization of the IPR belonging to the business group are as follows:

— the parent company provides advice on the content of the agreement, the negotiation method, and the like with regard to an IPR-related transaction or negotiation between a company in the business group and a third party;

— the parent company negotiates with a third party together with a company in the business group (or on behalf of that company) with regard to an IPR-related transaction or negotiation between the company in the business group and the third party;

— the parent company prepares such necessary documents as the contract document on behalf of a company in the business group with regard to an IPR-related agreement between the company in the business group and a third party; and

— the parent company receives or pays a royalty on behalf of a company in the business group with regard to an IPR-related agreement between the company in the business group and a third party.

(2) Detailed Study

The constituent elements of Article 72 of the Practicing Attorney Law can be summarized as follows:

① a person other than a lawyer;
② conducts legal affairs concerning law cases on behalf of the client;
③ has a purpose of gaining remuneration; and
④ conducts the act as business.

Of the above, "legal affairs" in (2) has been deemed in court decisions to be processing of matters that would bring about or change a legal effect (generally in a case where there is conflict or doubt concerning a legal right or obligation or where a new right or obligation arises). The specific acts that have been found to be "legal affairs" by courts include acts of claiming debts as proxy, accepting performance, and releasing a debtor from debts, as well as acts of claiming and receiving automobile liability insurance money. Such acts as preparing a contract document for finalized matters, which are the processing of matters that do not bring about or change a legal effect, but preserve or clarify a legal effect, are also regarded to be included in the "legal affairs." According to this view, the respective acts of (1) to (4) above, which can be assumed to be conducted by the parent company, would all be included in the "legal affairs."

Nevertheless, even when the parent company conducts "legal affairs" concerning the IPR of the business group, the acts do not violate Article 72 of the Practicing Attorney Law if the parent company does not have "the purpose to gain remuneration." Therefore, in order to avoid violation of Article 72, the parent company could be involved in utilization of the IPR of the business group without gaining remuneration, that is, free of charge. The

(*10) Yoshiyuki Tamura, *Fusei Kyousou Hou Gaisetsu* (Outline of the Unfair Competition Prevention Law): p. 259 (Yuhikaku, 1994).

"remuneration" here refers to compensation for handling the legal affairs, particularly for the mental effort involved, with regard to a specific law case. It is regarded as not only being limited to the form of cash, but also including gifts or dinner. The problem would be the parent company's act of receiving a reimbursement of the actual spent expenses for the utilization of the right (e.g., personnel expenses, travel expenses and communication expenses) from a company in the business group. However, it is reasonable to consider such actual expenses to be borne by the company in the business group in light of the purpose of the spending. In addition, the parent company merely gains reimbursement of the actual spent expenses, and not profits. Therefore, it should not be deemed as a "remuneration." Although no court decision is found to have rendered a judgment on this point, there is a view that the "remuneration should be carefully determined in regard to the portion of expenses necessary for processing the entrusted affairs which can be reimbursed under Article 650 of the Civil Code (the actual expenses)."(*11)

Meanwhile, courts have considered that "as business" in (4) "should refer to cases where one handles the above legal affairs repeatedly or with an intent to repeat and continue, and the act has come to take on the character of business,"(*12) and that "as long as an intent to repeat and continue is found, the amount of the concretely conducted acts do not matter."(*13) According to such viewpoint of courts, it would have to be interpreted that the parent company's act would correspond to "as a business" even when utilizing the IPR of such a specific company as a company in the same business group.

Ⅷ Closing

(1) As the method of compensation for an employee's invention of an operating subsidiary in Management Mode 1, the parent company needs to return a part of the profits gained by utilization of the right to the operating subsidiary. Since it is the operating subsidiary company, which is the "employer," that has the obligation to pay the "reasonable remuneration," it is necessary to create a rule where the subsidiary can secure funds for paying the "reasonable remuneration" within the business group.

(2) When the parent company claims for damages from an infringer of a right in Management Mode 1, the claimable amount would be an amount equivalent to the license fee. According to the current case law, however, the amount would be calculated based on a flat market rate, which makes it difficult for the business group to sufficiently cover the loss. Considered solely from the viewpoint of damages, the only desirable method in Management Mode 1 would be to grant monopolistic licenses to the operating subsidiaries; the options for the business group are thus limited.

(3) When applying the presumptive provision in Section 102(2) of the Patent Law to a case where a right is jointly owned by a parent company that does not engage in the manufacture and sale of the product relating to the patent and an operating subsidiary that engages in such business within the same business group, it is difficult for the operating subsidiary that has suffered the operating losses to compensate the losses sufficiently. This is because, according to the current case law, the infringer's amount of profits would be presumed as the amount of damages for the whole patent right and the damages awarded to the operating subsidiary would be the amount of presumed damages multiplied by the share of ownership of the right.

(4) In Management Mode 2, the legal standing of the company in which the IPR management function is allocated (parent company) should be sufficiently considered upon enforcement and licensing activities; the specific aspects to be considered include the company's right to sue, its eligibility to conduct ancillary intervention, and the issue of its conflict with Article 72 of the Lawyers Law.

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(*11) Edited and written by the Research Office of the Japan Federation of Bar Associations, *Joukai Bengoshi Hou <Dai Ni Han Hosei Ban>* (Explanation of Articles of the Lawyers Law <Revised Second Edition>): p. 529 (Koubundou, 1998).

(*12) Supreme Court Decision of April 4, 1975, *Saikou Saibansho Minji Hanrei Shuu* (Supreme Court Report <Civil Cases>), Vol. 29, No. 4: p. 317 and others.

(*13) Supreme Court Decision of December 5, 1959, *Saikou Saibansho Keiji Hanrei Shuu* (Supreme Court Report <Criminal Cases>), Vol. 13, No. 12: p. 3174 and others.