

**Reference Guideline
for
Intellectual Property Information Disclosure**

**In the Pursuit of Mutual Understanding
between Companies and Capital Markets
through Voluntary Disclosures of Information
on Patent and Technology**

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Chapter 1: Rationale and Background of Intellectual Property Information Disclosure

1. Reflection of Intellectual Property Information on Corporate Value

Becoming a nation that quests for sustained growth of its economy and society through vigorous promotion of creation, protection and exploitation of intellectual property, in short a “nation built on intellectual property,” is an urgent goal for Japan to strengthen its industrial competitiveness.

Since last year, various institutional reforms have been rapidly and concurrently set in motion, particularly in the areas of intellectual property creation and protection with an eye toward materializing such a nation built on intellectual property. The work has been promoted in accordance with the "Intellectual Property Policy Outline" and the "Strategic Program for the Creation, Protection and Exploitation of Intellectual Property (hereinafter referred to as the "Strategic Program for Intellectual Property").

To complete a “cycle of intellectual creation,” which consists of intellectual property creation, protection and exploitation, there is a need to dramatically enhance the exploitation of intellectual property, as well as its creation and protection. To achieve this goal, it is important that an environment is constructed that permits companies that practice “intellectual property-backed management”—companies that adopt management strategies to actively exploit their intellectual property—to receive fair valuation in the capital market while they strive to achieve sustained growth. It is hoped that such an environment will allow the number of such companies in Japan to surge, and that they will become leaders of the global market.

With such a vision in mind, the Ministry of Economy, Trade and Industry (hereinafter referred to as the "METI") established the "Guideline for Acquisition and Control of Intellectual Property" in March 2003, which the METI hopes will be used as a guideline by companies that position intellectual property as a source of their competitiveness in the realm of their management strategies and strive to strategically acquire and manage intellectual property. Around the same time, the METI also established a "Pilot Model for Disclosing Patent and Technical Information" with the hope that those companies that practice "intellectual property-backed management" will disclose information concerning their intellectual property and gain fair market valuation.

In the process of deliberation on the Guideline and the Pilot Model, several interesting facts came under light regarding Japan’s industrial competitiveness.

First of all, on a macro basis, a comparison of the relationship between Japan’s R&D and its competitiveness during the 1980s and 1990s revealed that the rate of technological advancement deteriorated despite an increase in R&D investment over this period. This was an exceptional situation not observed in any other developed nations, where an increase in R&D investment was found to be correlated to the rate of technological advancement. This suggests that Japan as a nation did not succeed in raising the R&D efficiency despite the critical need for implementation of high quality and efficient R&D through stepped-up

protection of intellectual property during this period in the face of increasingly fierce global market competition.

On a micro basis, it became evident that a correlation developed between R&D efficiency and corporate profitability in the 1990s, with the result that the R&D efficiency exerted great impact on profits. This implies that the weight of intellectual property rights is increasing as a factor determining corporate profitability. In fact, many excellent companies in the United States and elsewhere, as well as many Japanese companies that generate high profits amid the stagnant economic environment since the beginning of the 90's, practice intellectual property-backed management—management with a strong focus on intellectual property.

In the meantime, the capital market has seen that intangible assets, whose value equals the aggregate market value of stock less the portion that can be explained by tangible assets, have begun to account for an increasingly large percentage of corporate value in recent years. In particular, the importance of information concerning intellectual property as a component of intangible assets has been pointed out.¹ Different from information on tangible assets, however, information regarding intangible assets was found to have been disclosed to parties outside the companies in practically no instances. The only exceptions were found among a limited number of progressive companies.²

If such a situation continues, the asymmetry of information between companies and capital market participants (including institutional investors, private investors and analysts) will become even more punctuated,³ with the result that companies that adopt excellent intellectual property management strategies might not receive proper valuation. Alternatively, they many have to endure high capital cost even if they deploy superb intellectual property management strategies.

In order to promote the further exploitation of intellectual property in the pursuit of establishing a nation built on intellectual property, what is important is the efforts initiated by companies themselves to recognize the importance of intellectual property from viewpoints of enhancing their competitiveness and maximizing their corporate value and to develop an

¹ A questionnaire-based survey by the Japan Academic Society of Investor Relations (IR), which was conducted to see what value among the values not shown in financial statements, such as intangible assets, investors consider, showed that they attach importance to information disclosure (ranked first) and information on technologies and intellectual property (ranked second) (source: *Nihon Keizai Shimbun* morning edition, June 19, 2002).

² According to a survey by late Mr. Shunsuke Watanabe (then President of **Linx Pro, Co.**) that covered 100 leading manufacturing companies, 52 among them were disclosing technical and patent information in some form but only approximately 10 of them were found to be offering any quantitative information (conducted from December 2001 to January 2002) (*Chiteki Zaisan* (Intellectual Property), written and edited by Shunsuke Watanabe, published by Toyo Keizai Inc.) (*Keiri Joho* (Accounting Information), April 10, 2002).

³ An increased imbalance in information would generate a risk of adverse selection where a company is evaluated only at mean values, with excellent companies undervalued and their capital cost increased as a result. This would therefore lead to the stagnation of overall markets and also the loss of profit-generating opportunity on the part of investors.

intellectual property strategy in linkage with their business and R&D strategies. At the same time, it is also vital that the efforts of those companies which vigorously pursue such an intellectual property-backed management should be valued fairly when they disclose to capital markets their mode of business operation under their unified strategy on three different focuses, *i.e.*, business, R&D and intellectual property. These elements are crucial in order for Japanese companies to survive global market competition and R&D competition in the future.

Under such a notion and in anticipation that mutual understanding will be established between companies and capital markets on issues of intellectual property-backed management, this Guideline is intended to provide a benchmark for intellectual property information disclosure.

2. Background

The Japanese government published the Intellectual Property Policy Outline in July 2002 as a specific step for a reform aimed at revitalizing the Japanese economy and culture through the further promotion of the creation, as well as the proper protection and exploitation, of intellectual property, which is poised to become a source of Japan's national wealth. After the enactment of the Intellectual Property Basic Law that followed in November of the same year, the Intellectual Property Policy Headquarters also released the "Strategic Program for Intellectual Property" in July 2003, which requires each public agency to implement specific measures. The government is thus accelerating the pace of reform aimed at establishing Japan as a "nation built on intellectual property."

The Strategic Program for Intellectual Property describes the intellectual property information disclosure as follows:

Chapter 3: Intellectual Property Exploitation
1. Support for the Strategic Exploitation of Intellectual Property
(2) Promoting Disclosure of Information on Intellectual Property
It is necessary to consider an ideal disclosure system in which the securities markets would be able to properly evaluate how individual companies recognize intellectual property in connection with their business. Accordingly, the GOJ will take the following measures to encourage companies to voluntarily disclose information on intellectual property, following the examples of environmental reporting and accounting. However, whether or not to disclose information should be decided by individual companies based on their own judgments.
i) For the purpose of improving interaction between intellectual property and securities markets, by the end of FY 2003, the GOJ will formulate feasible guidelines for promoting disclosure of information on intellectual property according to the "Pilot Model for Disclosure of Patent and Technology Information" prepared by the Ministry of Economy, Trade and Industry (released in March 2003).
(Ministry of Economy, Trade and Industry)
ii) In FY 2003, the GOJ will start discussing an ideal way of including statements regarding intellectual property in securities reports and of disclosing accounting information.
(Financial Service Agency; Ministry of Economy, Trade and Industry)

The Strategic Program for Intellectual Property expects companies to proactively position

intellectual property as a source of their competitiveness within their corporate strategy and, by incorporating such an approach into their business activities, to successfully augment their profitability and corporate value. On the subject of the relationship with capital markets, the Program also desires that companies' efforts in applying an intellectual property strategy that functions with their business strategies and R&D strategies as one entity be valued fairly.

The METI started examining this issue seriously in fiscal 2002, and the Subcommittee on Management and Market Environment of the Intellectual Property Policy Committee of the Industrial Structure Council drew up "A Pilot Model for Disclosing Patent and Technical Information" (hereinafter referred to as the "Pilot Model") in March 2003. Furthermore, in fiscal 2003, the Subcommittee on Management and Information Disclosure of the Intellectual Property Policy Committee of the Industrial Structure Council has been examining the issue by revising the Pilot Model, in consideration of the results of a trial project for the Pilot Model participated in by 13 companies and the criticisms from market players, with the intention of establishing a guideline for information disclosure as directed in the Strategic Program for Intellectual Property.

This Guideline outlines appropriate items of information disclosure regarding intellectual property that companies which make strategic efforts in intellectual property-backed management to enhance their competitiveness and maximize their corporate value will need in evaluating their corporate value or revising such estimates, so that their efforts will be valued appropriately when they communicate with investors in marketplaces. Accordingly, this Guideline should not be viewed as imposing legal or regulatory requirements but as a tool that is made available strictly for the convenience of both companies and investors.

As companies will, through the use of this Guideline as reference, strategically disclose information on their strategic acquisition, management and exploitation of intellectual property and such efforts will be valued fairly, it is expected that an environment in which companies augment their corporate value will be set in place and thereby a shift of the Japanese economy towards a high value-added economy will be facilitated and Japan's industrial competitiveness be augmented.

3. Targeted Scope of Intellectual Property

For the purpose of this Guideline, "intellectual property" means inventions, devices, new varieties of plants, designs, works and other property that is produced through creative activities by human beings (including discovered or solved laws of nature or natural phenomena that are industrially applicable), trademarks, trade names and other marks that are used to indicate goods or services in business activities, and trade secrets and other technical or business information that is useful for business activities. (Article 2 in Chapter 1 of the Intellectual Property Basic Law)

What this Guideline particularly targets, however, is a case in which information related to intellectual property, especially patents, and R&D of a company in the manufacturing industry is to be disclosed in the context of a triangular relationship among business strategies, R&D strategies, and intellectual property strategies. Application to companies in non-manufacturing industries should be examined when appropriate depending on the

importance of intellectual property, such as patents, and R&D in a given business field.

Chapter 2: Ideas Behind Intellectual Property Information Disclosure

1. Investor Relations

As intellectual property information disclosure reflects a company's intellectual property-backed management, it should be implemented as part of investor relations (hereinafter referred to as "IR") activities. IR represents a combination of financial affairs, marketing and communication activities directed to capital markets, and is a strategic issue that company managements should address and assume accountability for while anticipating a proper valuation in marketplaces and augmentation of their corporate value.

During IR activities, information containing indefinite factors, such as incidents in the future, is sometimes required to be disclosed. Disclosure of such information may be followed by a certain risk. Avoiding that risk, as an exemption rule, there is a safe harbor rule, which may allow the avoidance of risks of information disclosure and the exemption of responsibilities of the disclosing party by noting disclaimer with respect to the risks related to indefinite factors. I.e., by keeping disclaiming notes, risks associated with disclosure of indefinite factors can be avoided.

A disclosure policy may compose a pair with the said safe harbor rule. That is a policy regarding who disclose the information with responsibility under what specific rule, with what kind of contents as a company at the time of disclosing information. For example, "Not to disclose any information which is highly indefinite," "Not to disclose any information accompanied by confidential obligation," or "Not to disclose details of any information which is strategically important" can be a part of a disclosure policy. By indicating such a policy itself, it is expected to make the meaning of disclosed information clearer, and to augment credibility.

2. Ideas Behind This Guideline

This Guideline is formulated in consideration of requests from investors and constraints to companies and for the purpose of establishing interactive communication between companies and markets on the subject of intellectual property-backed management, so that companies will be able to disclose efficiently and effectively to markets how they exploit intellectual property information, which is a source of future profits, as a strictly voluntary disclosure initiative within their IR activities.

Specifically, it is desirable that disclosure will be implemented in accordance with the following ideas:

(1) Requests from Investors

Investors tend to be more interested in knowing how patents and technologies tie in with a corporation's strategies and organization rather than the details of such patents and technologies. It is therefore desired that companies communicate their stance on this issue to

the market to the extent possible, and also strive to incorporate the feedback from the market in their corporate management.

According to a questionnaire-based survey of institutional investors conducted by the "Study Group on Patent and Technical Information Disclosure" (research commissioned by the METI) in October 2003, the following items were found to likely be used by investors as a basis of judgment in evaluating corporate value and not to be disclosed sufficiently despite the needs on the part of investors:

1) Items of particularly high requests

a) outline of the company's core technology

b) corporate or business strategy

c) risk information concerning intellectual property, such as basic patent expiry dates and details of legal actions

2) Items of high requests

a) percentage of main products (and basic patents) to total sales

b) analysis and discussion by the management about the marketability and market advantages of technologies

c) the company's business models

Together with the above, some also responded that they would like to obtain information used by the company for internal control purposes, including policies regarding intellectual property portfolio and intellectual property acquisition status.

Also among the responses, furthermore, was a request that, for better investment decisions, the aforementioned information be substantiated with the context used as preconditions and quantitative substantiation when disclosed.

(2) Constraints to Companies

Each company controls technical information that belongs to "trade secrets" within its intellectual property strategy, and this Guideline is not intended to request the disclosure of such trade secrets. Technical information belonging to trade secrets may include, for example, technical information prior to patent application filings and production know-how, because leakage of such information outside of the company might do harm to the company's competitiveness.

On the other hand, the same survey also revealed that what investors want is not individual and specific patent and technical information but information that supports corporate messages delivered by the company's top-level management within its IR activities, *i.e.*, information that shows that "intellectual property-backed management" is put into practice.

The company side expressed concerns during the discussions on this Guideline that markets might demand the disclosure of trade secrets as mentioned above, but investors are not demanding the disclosure of trade secrets. If requested to disclose trade secrets, refusing such disclosure as a strategic decision is also vital for companies.

(3) Ideas of Disclosure Under This Guideline

1) Strictly voluntary disclosure

This Guideline has been established as a benchmark provided by the METI from a standpoint of industrial policy and intellectual property policy, in the expectation that intellectual property-backed management will be promoted and companies practicing it will be valued properly, and is not intended to force or regulate disclosure by market players. Accordingly, any disclosure implemented in accordance with this Guideline is strictly on a voluntary basis, which functions as a common language of communication, so to speak, between companies and markets on the subject of intellectual property.

2) Manifestation of "intellectual property-backed management"

What markets want is information on intellectual property-backed management or the lack thereof, *i.e.*, whether three strategies on business, R&D and intellectual property are formulated and implemented as one entity, and not a trade secret in itself, such as technical information prior to patent application filings and production know-how, as discussed above. The objective of this Guideline is to present a true picture of corporate intellectual property management, premised upon such demand of the market. The mission of the Guideline is to provide a gauge with which to determine whether or not messages delivered by top management in the course of their IR activities are credible, and to correctly communicate to the market whether or not a particular company has the potential for sustained growth.

3) Substantiation with underlying assumptions and quantitative data

Patents and technologies differ from personal and real properties that are accounted for in financial statements in one major respect: the former are difficult to value, due to the absence of objective external markets. It is therefore crucially important to make interpretation of information on intellectual property that is disclosed. The market finds it difficult to accept disclosed information unless it is substantiated with assumptions and quantitative data that support the information. Some corporations expressed their concerns during the course of deliberation on this Guideline that furnishing quantitative substantiation might mislead the market. However, this subcommittee holds a view that it is more desirable that disclosure is accompanied by underlying assumptions and quantitative substantiation as much as possible in order to avoid any misinterpretation and entice an appropriate valuation.

4) Disclosure on a consolidated and segment-specific basis

In corporate accounting, disclosure is made both on a consolidated basis, which includes subsidiaries and affiliates, and on a segment-by-segment basis, which represent true units of business operation. It would benefit investors' understanding to structure the disclosure of intellectual property information on similar basis.

In disclosures on a consolidated basis, such inter-company items as licensing income among subsidiaries and affiliates are mutually offset, which is important in the sense that the actual profit-earning capability of the group is revealed. On the other hand, in terms of revealing the profit-earning capacity of individual business units, disclosure of information regarding individual segments, which are the genuine units of business operation, is also desired to augment information disclosure strictly for the formality of the company as a unit.

It is further desired that, in the event that segment-by-segment disclosure is made in addition to disclosure on a consolidated basis, consistency be maintained in the format and assumptions with respect to the information that is disclosed about individual segments and the corporate group as a whole so that understanding by investors who are the recipient of such information is facilitated.

5) Effectiveness with small-, medium-sized and startup companies as well as with major corporations

For the purpose of creating this Guideline, discussions have been held with a focus on major companies that participated in the study group. However, the effectiveness of intellectual property information disclosure is certainly not constricted by the company size. It is equally useful for small- and medium-sized corporations and startup companies. In many instances, intellectual property information disclosure actually works more effectively for small- and medium-sized corporations and startup companies because intellectual property accounts for a large part of the managerial assets in many of these companies. In fact, more than a few of these companies already disclose a substantial amount of their intellectual property information to facilitate their financing.

Chapter 3: Media for Intellectual Property Information Disclosure

1. Media for Information Disclosure

Corporations, as disclosing parties, need to select appropriate media by taking into account the contents of information to be disclosed, and by considering the recipients' needs. Media for disclosure may include financial highlights, business reports, annual reports, documents for IR briefings, verbal explanations and publication on websites. However, investors have strong preference for disclosure of the direction of a corporation's intellectual property-backed management in a concise summary format. It is therefore desired that a corporation creates an "intellectual property report" by pulling together various pieces of information that are scattered in multiple documents, and reorganizing them, for example in an annual report, in such a manner as to be consistent with the perspective of intellectual property-backed management.

2. Relationship with Required Disclosure

Disclosure under this Guideline is not a statutory or regulatory requirement. It is therefore desired that companies that make disclosure will select the media for and the methods of disclosure by taking into consideration the convenience to market participants and base their choices on corporate strategic judgments.

3. Organizational Efforts towards Disclosure

IR issues should ultimately be the responsibility of the management. Corporations are therefore asked to make system-wide efforts to ensure that disclosure is made with consistency and in accordance with certain established policies.

Chapter 4: Items of Intellectual Property Information Disclosure

The following is the description of the desirable items of intellectual property information disclosure that are beneficial to investors in making investment decisions:

1. Core Technologies and Business Models

Disclosure examples (Effects expected):

- Specification of core technologies (sources of competitive advantages)
- Segment-specific R&D investment expenditures (projection of corporate growth and its orientation)
- R&D visions and business models (projection of corporate growth and its orientation, confirmation of a profit-earning structure)

(Grounds)

Clear presentation of a corporation's core technology is important to enable determination of the corporation's profit structure and balance, its future competitive advantages, and the potential of future profit-earning capabilities. Proper disclosure is therefore desired. In addition, the amounts of investment in R&D by individual segments are important as they form the basis of inference as to the key investment strategies adopted by the corporation, and the direction of its growth.

In most cases, as the link between the quality of a patented item or technology and the business model for that item or technology is likely the most vital basis of investment decisions with respect to small- and medium-sized enterprises and startup enterprises, even more detailed explanation needs to be provided, *e.g.*, presentation of its advantages that competitors lack.

2. R&D Segment and Business Strategy Orientation

Disclosure examples (Effects expected):

- Overview and orientation of the business strategy for each R&D area (recognition of future cash flow sources and projection of growth potential)

(Grounds)

In many of the corporations in which R&D directly leads to profits, three types of strategies, consisting of business strategies, R&D strategies and intellectual property strategies, are integrated into a whole and function seamlessly. In other words, these corporations can be said to maintain and improve their profit-earning capability by conscientiously aligning its investment in R&D with their business strategies. Accordingly, analyzing the R&D segment in relation to a company's business strategies will facilitate forecasts on the growth potential of the company.

The type of information discussed here that is required regarding "business strategy" is the ballpark orientation of the company and does not refer to detailed, individual and specific technical information concerning its trade secrets. It is also not the point to demand the disclosure of information that should be kept confidential in relationship with other companies, including competitors and partner companies. Furthermore, any information that is highly uncertain and might mislead stakeholders should not be disclosed with the use of an

assertive expression. In disclosing conjectural information, the preconditions for such conjecture should be disclosed together.

3. R&D Segment and Intellectual Property Overview

Disclosure examples (Effects expected):

- Types of core intellectual property and their current or potential use (projection of future cash flow growth potential)

(Grounds)

Disclosure of an overview of intellectual property that has already been acquired or is hoped to be acquired, together with the analysis discussed in Disclosure Item 2, clarifies the mutually intertwined relationship among the business strategies, R&D strategies, and intellectual property strategies, and reveals the strategic deployment of the three. Accordingly, it can be said that knowledge of whether or not a corporation has been able to acquire intellectual property that is compatible with its business strategies is important for determining the growth potential of the corporations' future cash flow. For this reason, it is desired that the overview of intellectual property be disclosed in a manner that reveals how the disclosed intellectual property relates to the uniqueness of the corporation and its competitive advantages.

When intellectual property overviews in simplex advanced technology fields are compared to those in multiplex advanced technology fields, profitability generated from a single patent is normally quite different between the two. Therefore, some ingenuity will be required so that the disclosure method should fit the type of technology.

The aforementioned survey suggests that the amount of sales proceeds of a company's main products and services and its percentage to the total sales of the company would be useful items of disclosure. Information regarding the time-series shift of the percentage of new product sales to the total sales is also cited as a useful piece of information. It is desirable that information that is utilized for a company's management control and is useful to investors will be disclosed together to the extent possible.

4. Analysis of Marketability and Market Advantages of Technologies

Disclosure examples (Effects expected):

- Information showing the accumulation of intellectual property and technologies in areas of competitive advantages (projection of future cash flow and its timing and growth potential)
- Use of technologies, potential customers, market growth possibility (same as above)

(Grounds)

With regard to intellectual property that enables a product or service to be differentiated, i.e. intellectual property that forms the basis of special functions, added value or superb designs, it would be beneficial for the management to analyze and present the characteristics, size and growth potential of the market for such a product or service, as well as the market competitiveness that will be endowed upon the corporation by the intellectual property, and exchange opinions with market participants. It is expected that such an effort will help bring the corporate perspective and the perspective of the market closer together.

Analyzing marketability and market advantages is essentially a task left to market players. The analysis by the management being called for here is intended for the purpose of trying the power of imagination of the management and offering a material for idea exchanges. In carrying out such analysis, its preconditions need to be explained together.

From a perspective of small- and medium-sized enterprises and startup enterprises, it will be also important to explain the advantages of their own patents over preceding technologies and patents.

5. R&D and Intellectual Property Organizational Chart, R&D Alliances

Disclosure examples (Effects expected):

- R&D organizational chart and intellectual property management organization (confirmation of the orientation of future corporate growth and strategic intellectual property management, expectation regarding the pace of commercialization from R&D)
- Strategic R&D alliances (confirmation of strategic intellectual property management)

(Grounds)

It is important for the organizational configuration of a corporation to be congruous with its management strategies and its market environment. Furthermore, proper disclosure of the following types of information are desired because they are useful in the analysis of the efficiency of corporate organizations: the positioning of R&D organization and that of the intellectual property management organization within the organizational configuration that encompasses the entire corporation, such as a holding-company structure or a company-within-a-company structure; overview of R&D alliances; and an outline of the corporation's involvement with outside entities, such as participation in a patent pool. Information concerning a corporation's investment in another company for the purpose of forming a technical alliance is also an important piece of information for gauging the technological strength of the corporation. It is possible that such information is disclosed under this item.

Notice should be taken that disclosure called for in this section is not intended to request inside information on a corporation organization in minute details.

Likewise, disclosure about R&D alliances is intended for the purpose of knowing if external resources are exploited as necessary and appropriate, and of course not for the purpose of demanding the formation of any R&D alliance when it is not necessary. It is also not intended to demand the disclosure of information that should be kept confidential, such as contractual terms, etc. with other organizations.

From a perspective of small- and medium-sized enterprises and startup enterprises, information on their R&D alliances will likely be weighed more heavily.

6. Intellectual Property Acquisition and Management, Trade Secret Management, Policies on Technology Leakage Prevention (Including Guideline Implementation)

Disclosure examples (Effects expected):

- The fact that a certain guideline is implemented in light of the business strategy (projection

of soundness of the corporate operation process)

(Grounds)

Integrated operation of intellectual property acquisition and management, trade secret management and technology leakage prevention, etc. curtails any damage to intellectual property and also provides implications for enhanced efficiency in the wealth generation process.

It is desirable that disclosure of the strategy on intellectual properties pertaining to intellectual property acquisition and management will show if such efforts are implemented in conjunction with business strategies and R&D strategies, and the state of efforts towards intellectual property-backed management. With regard to training of workers to build and maintain an outstanding work force, disclosure of information concerning incentives that a corporation gives to its employees for the purpose of encouraging the creation of intellectual property is desired. Disclosure of company regulations concerning compensation, bonuses or awards that are granted to employees who create inventions on the job is especially desirable.

It is also desirable that the disclosure of trade secret management and technology leakage prevention will show if the company has set in place an organization-wide strategy and structure that include international perspectives, so as not to have its internally-kept technical information, etc. leak outside of the company in the absence of any such intention.

7. Significance of the Licensing Activities to the Company's Business

(1) In the case of a company whose incomes from patent licensing, etc. have a more significant weight in its operation than other incomes

Disclosure examples (Effects expected):

- Licensing incomes and expenditures by main segment or area of technology, their strategic rationale (confirmation of actual cash flows, projection of stability)

(2) In the case of a company that applies a strategy focusing more on its own use of patents

Disclosure examples (Effects expected):

- Strategic patent licensing policies, cross-licensing, etc. (confirmation of actual cash flows, projection of stability)

(Grounds)

The degree of contribution by license-related activities to business varies greatly between (1) companies whose incomes from patent licensing have a significant weight in their corporate income and (2) companies that apply a strategy focusing on their own use of patents. For this disclosure item, therefore, different methods of disclosure are described which are deemed desirable, depending on the type of company.

When incomes and expenditures regarding intellectual property are placed in the center of a company's business model as in the case of Type (1) companies, *i.e.*, R&D companies often seen in the United States, information disclosed regarding licensing incomes and expenditures is necessary as an important basis of judgment for investors. However, licensing income is rarely presented as a line item in accounting reports. Instead, it is ordinarily included in the non-operating income. Accordingly, the positioning of licensing income in the corporate

profit structure is not easily discerned in standard financial statements. Consequently, it is possible for investors to be unaware of a change in the business structure of a corporation when it transforms itself into a kind of entity that relies on continuous cash flow from the application of its intellectual property. It is therefore desirable for corporations of the first type to disclose licensing income and expenditure totals for each of their major segments or technology fields.

Disclosure of information concerning overseas licensing arrangements, in addition to information on domestic licensing incomes and expenditures, is also desired if they are important for management strategies of the corporation. In this case, the information may be disclosed on a country by country basis for each of the major partner countries.

It should be noted that for the purpose of this Guideline, “licensing incomes” refer to basically patent royalty incomes and may include initial lump-sum fees at the time of granting a license, etc. As a definition applied in accounting for licensing incomes likely differs from company to company, it is desirable that disclosure will be implemented together with the definition.

In contrast, information described under Disclosure Item 8 hereunder (Significance of the Patent Portfolio to the Company’s Business) is requested as important information from corporations of the second type—those which adopt strategies that are focused on the use of patents in house, as many Japanese manufacturing companies do. With respect to Disclosure Item 7 (Significance of the Licensing Activities to the Company’s Business), on the other hand, a corporation that uses cross-licensing for strategic reasons, for instance, may only need to provide an explanation to that effect. Disclosure of any additional information is not needed as such information as quantitative data may have the effect of unintentionally misleading the market.

8. Significance of the Patent Portfolio to the Company’s Business

(1) In the case of a company whose incomes from patent licensing, etc. have a more significant weight in its operation than other incomes

Disclosure examples (Effects expected):

- Number of acquired patents by main segment or area of technology and their strategic rationale (confirmation of cash flow sources, projection of stability)

(2) In the case of a company that applies a strategy focusing more on its own use of patents

Disclosure examples (Effects expected):

- Number of acquired patents classified by main segment or area of technology, as well as by use (patents currently in use by the company, patents scheduled for future commercialization, defense patents and other patents) and their strategic rationale (confirmation of cash flow sources, projection of stability)

*For “classification by use,” when the company has some strategic or any other compelling reasons to do so, following options may also be taken i.e., simplified classification consisting of two categories of "patents currently in use by the company" and "other patents," or not showing any use-based classification.

(Grounds)

It is hoped that disclosure of quantitative data that indicate the relationship between the acquisition and management of patents and the company's competitive advantages will serve

as objective substantiation of the qualitative descriptions about the integrative deployment of the company's business strategies, R&D strategies and intellectual property strategies that are revealed in the disclosed information.

In the case of (1) a company whose incomes from patent licensing, etc. have a significant weight in its operation, it will be enough to show the number of acquired patents by main segment or area of technology under this disclosure item, because its significance of patents to the company's business would be shown under Disclosure Item 7 (Significance of the Licensing Activities to the Company's Business).

In the case of (2) a company that applies a strategy focusing on its own use of patents, on the other hand, it is desirable that information that offers an overview of the state of its significance of the patent portfolio to the company's current and future business and the state of patent acquisition as an outcome of its R&D investment will be disclosed, together with specific explanations on those matters.

Such information is intended to provide indications of the company's strategies for intellectual property acquisition and management, the time period in which the company can enjoy its competitive advantages in the markets of its core products, and the status of its management resource allocations. Accordingly, it is desired that information is presented in such a manner as to demonstrate that the corporation acquires and manages patents properly in accordance with its business and R&D strategies. For example, the number of owned patents may be compiled in a number of different ways, including by type of business, technology or patent, by different ways in which such patents are used (patents that are currently used in house, patents that are planned for future commercialization, patents to be defended, etc.), or by the character of the patents (by using such classification as basic patents, improvement patents, etc.).

If the issue is vital under the company's management strategy, whether it is categorized under (1) or (2), it is also an idea to include information on overseas deals or information by main country, etc., rather than disclosing domestic deals only.

9. Policies on Intellectual Property Portfolio

Disclosure examples (Effects expected):

- The fact of portfolio-based intellectual property management (reduction of opportunity cost, expectation for economic value creation)

(Grounds)

Disclosure of information concerning intellectual property that is organized in a number of different ways, such as by type of business, technology or patent, by different ways in which such patents are used, or by the character of the patents, and that of information that indicates the corporation's policy toward its intellectual property portfolio, such as the schedule of its R&D investment allocations, provides indication of what kind of intellectual properties that the corporation as a whole depends on, or intends to depend on, to generate profits, and facilitates the analysis of its future profitability and medium- to long-term growth potential.

In the event disclosure of such information is difficult, explaining the company's stance and

policies may prove to be effective. An example of this may be to go beyond an explanation of the corporation's current situation and explain its stance on building a systematic inventory of patents for future.

10. Information on Risk Countermeasures

Disclosure examples (Effects expected):

- Legal actions against intellectual property right infringement (offense and defense)
- Impact of changes in patent and licensing agreements and relevant laws and regulations on cash flows, and measures to apply on such occasions (projection of duration of the period of competitive advantages, projection of establishment of a risk and crisis management structure)

(Grounds)

With regard to patents that make significant contributions to profits, failure to disclose facts that have the potential of exerting serious impact on the corporate value, such as expiration or filing of lawsuit challenging the patent validity, in a timely manner can cause market participants to develop a sense of mistrust. Timely disclosure of action taken by a company in the face of such development will enable it to contain fluctuations in its corporate value to a minimum.

It is desirable that such information concerning how a corporation responds to risks is disclosed using appropriate media and at appropriate timings whenever risks that can exert significant impact on the corporate value arise.

Small- and medium-sized corporations, as well as startup companies, should be prepared to provide information on earlier patents against which the patents that form the core of the companies' business have the potential of infringing, and information on issues relating to future business expansions.

Chapter 5: Expectation for Use of Disclosed Information

In conclusion, an overview will be provided with respect to expected uses of intellectual property information voluntarily disclosed in accordance with this Guideline.

This Guideline recommends the disclosure of intellectual property information as a basic tool for boosting interactive communication between companies and markets. Therefore, the essential objective of this Guideline cannot necessarily be fulfilled if companies do not act any further than to issue reports in accordance with this Guideline. Similarly, it will not be enough if passively receiving reports issued by companies is the only end result on the part of investors. Hence, it is expected that the following activities will be performed by both sides, respectively, as means to facilitate improved interactive communication.

The company side is expected, among other things, to issue intellectual property reports together with annual reports on a regular and continual basis, offer the said reports via the Internet so that they are widely available to the general public, and have the management regularly hold briefing sessions for investors that are based on the said reports and focus on intellectual property. Through such activities of information dissemination and investor

briefing, various issues that have often been pointed out regarding intellectual property information disclosure (for example, issues on "misleading potential" and "arbitrary interpretation of numbers") will likely diminish over time.

On the other hand, the investor side is expected to develop the ability to determine the growth potential and durability of a company's profit-generating capacity from a perspective of contribution by intellectual properties to business activities on the basis of reports issued by the company in accordance with this Guideline, rather than blindly receiving fragmented pieces of information. As a matter of course, investors are expected to take the initiative, as necessary, to collect and analyze information, starting with information issued regularly by companies and followed by the use of other available information sources and hearings from target companies, etc.

By thus facilitating improved interactive communication, it is expected that companies which practice intellectual property-backed management will be valued properly by markets, and thereby a shift towards a high-value added economy will be promoted in Japan and Japan will successfully become a nation built on intellectual property.