Fact-finding Survey on Business Practices of Start-ups

（Summary）

Purpose of the Survey, etc.

公正取引委員会 Japan Fair Trade Commission

○ Start-ups have the potential to greatly contribute to the productivity improvement of the Japanese economy by promoting innovation, and open innovation with large companies, etc. has been accelerated in recent years.

○ Start-ups are also important in terms of creation of new jobs, with companies in business for less than 10 years showing a tendency to increase their workers.

Therefore, it is crucial for the future Japanese economic development to ensure an environment in which start-ups can compete fairly and freely.

- The survey started in November 2019. A questionnaire survey and an interview survey were conducted.
- The questionnaire was sent to 5,593 start-ups, of which 1,447 responded (response rate: about 25.9%).
- The interviews were held with 144 parties.

(126 start-ups, 5 investors, 10 experts, and 3 trade associations)

Outline of Start-ups

Definition of a "start-up" in this survey

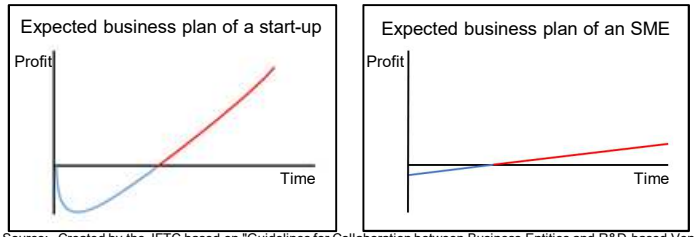
- In business for about 10 years
- An unlisted company
- Conducting innovative business activities in a growth sector

Differences between a start-up and a small- and medium-sized enterprise (SME)

[Difference in the business plan]
- A start-up temporarily posts a deficit, but later increases its sales significantly in a short term in the monetizing stage (so-called "J curve").
- An SME grows linearly by gradually expanding its scale.

[Difference in the field of business activities]
- A start-up mainly aims to conduct business activities in a field where sufficient demand has yet to emerge, etc.
- An SME mainly aims to conduct business activities in a field where a business model has already been established.

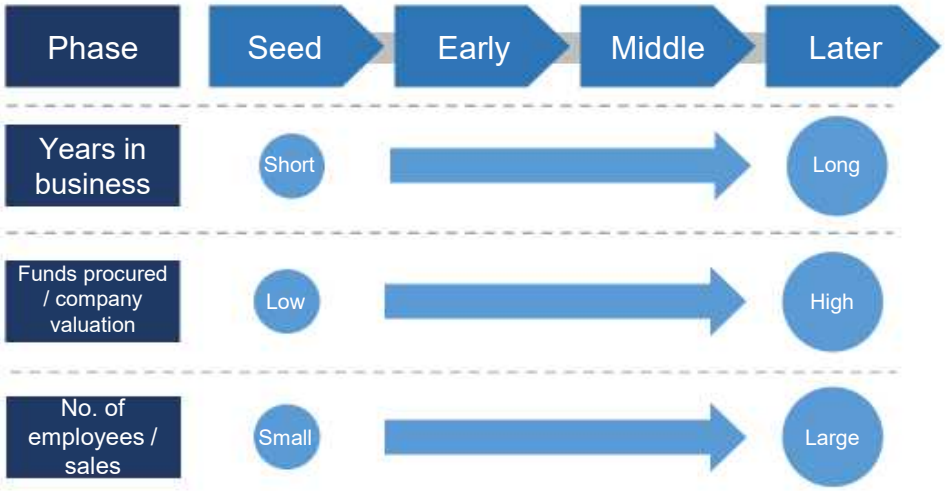
[Difference in the business fund procurement method]
- A start-up acquires the funds necessary for its business activities by receiving investments (it is difficult to receive a loan from a financial institution).
- An SME acquires the funds necessary for its business activities by receiving loans.



Source: Created by the JFTC based on "Guidelines for Collaboration between Business Entities and R&D-based Venture Businesses (Second Edition)" (METI).

Growth model of a start-up

- A start-up grows in phases from "seed," "early," "middle," to "later."
- In the "seed" phase, only the founder and a few other members conduct business, and the company engages in technology research and product development.
- In the "early" phase, the company acquires customers through sale of initial products, and increases the number of workers in sales and marketing, etc.
- In the "middle" phase, the sales amounts of the products increase and the company builds a back-office framework.
- In the "later" phase, the company expands in scale and prepares for an initial public offering (IPO) or merger and acquisition (M&A).

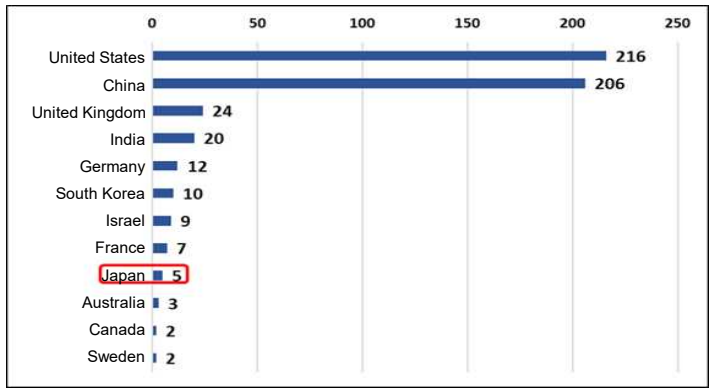


Source: Created by the JFTC based on the survey results.

Outline of the Fact-finding Survey (Amount of Investments in Start-ups in Japan, etc.)

公正取引委員会 Japan Fair Trade Commission

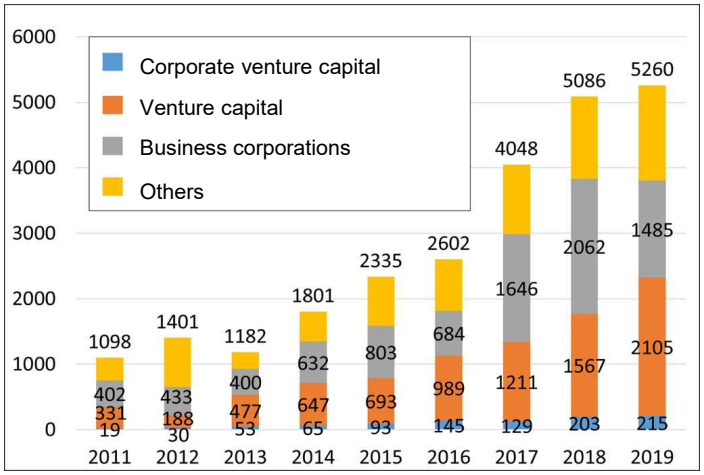
Number of unicorns by country



Source: Created by the JFTC based on data published on INITIAL (data as of February 7, 2020 and data as of February 10, 2020).
In this table, the criterion for a unicorn company is having a valuation of 1 billion US dollars or more (the exchange rate at the time $1=¥110 is used for the conversion).

- A start-up valued at $1 billion or more is called a unicorn company.
- As of February 2020, there were 5 unicorn companies in Japan.

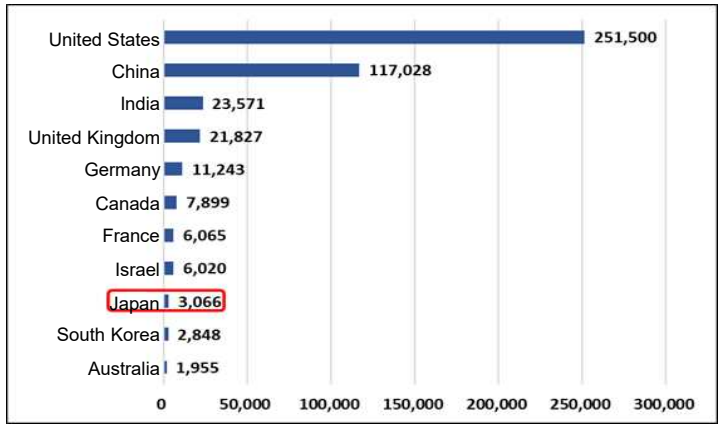
Changes in the amount of investments in start-ups



Source: Created by the JFTC based on data published in "Japan Startup Finance 2020 First Half."

- The amount of investments in start-ups in Japan has been on a rise.
  ¥180.1 billion (2014) → ¥260.2 billion (2016) → ¥526.0 billion (2019)

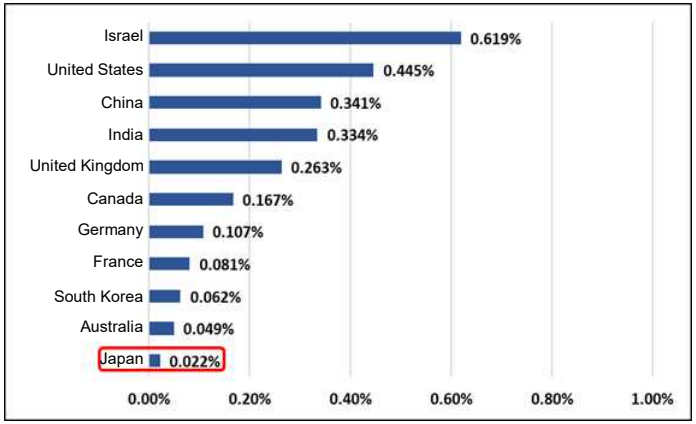
Amount of investments in start-ups in major countries of the world 2015 to 2017 ($ million)



Source: Created by the JFTC based on RISE OF THE GLOBAL START UP CITY.

- The amount of investments in start-ups in Japan over this period was approximately $3.1 billion, which is only about 1.2% of the investments in the United States and about 2.6% of the investments in China.

Amount of investments in start-ups in major countries of the world 2015 to 2017 (% of GDP)



Source: Created by the JFTC based on RISE OF THE GLOBAL START UP CITY and National Accounts.

- The amount of investments in start-ups in Japan over this period was approximately 0.02% of the GDP, which is one of the lowest percentages among major countries of the world in comparison to the country's economic scale.

公正取引委員会 Japan Fair Trade Commission

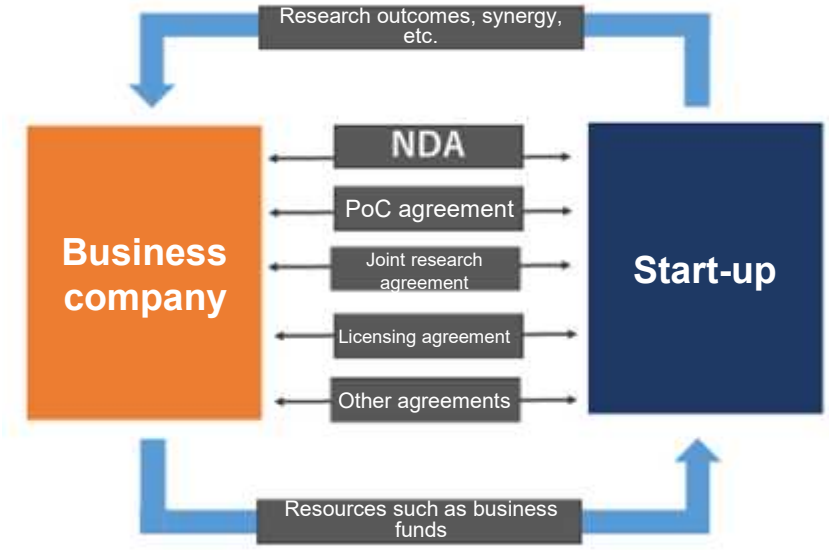
Relationship of transactions/agreements between a start-up and a partner business (1)

■ When forming a business partnership, the transactions and agreements set forth in [i] through [iv] below are generally conducted/concluded.

[i] Non-disclosure agreement (NDA)	[ii] Proof of concept (PoC) agreement	[iii] Joint research agreement	[iv] Licensing agreement
• Prohibition of use of the trading counterparty's technology, know-how, etc. for a purpose other than the purpose of the trading • Prohibition of disclosure/leaking of confidential information to another enterprise, etc.	• A verification step for determining what can be done when the start-up's technology is combined with the partner business' resources	• Decision on the burdening of resources and attribution of intellectual property rights when the start-up and the partner business jointly conduct research/development	• Arrangements between the start-up and the partner business regarding joint research outcomes, such as the license fees and the license period

Source: Created by the JFTC based on the survey results.

Relationship of transactions/agreements between a start-up and a partner business (2)



Source: Created by the JFTC based on the survey results.

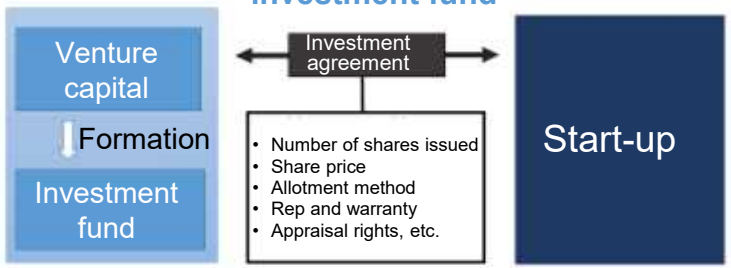
■ While start-ups have ideas on technology or business, they often do not have factors of production, such as big data and manufacturing equipment for conducting research to materialize those ideas, and sales channels, etc. Therefore, start-ups tend to conduct continuous transactions with enterprises for the purpose of business partnerships (partner businesses) to complement such factors of production and sales channels, etc.

■ By forming business partnerships with start-ups that have innovative technology and ideas, partner businesses will be able to not only think about creating innovative technology and improving productivity in their own business domain, but also about advancing to a new business domain.

Outline of the Fact-finding Survey (Relationship Between a Start-up and an Investor)

公正取引委員会
Japan Fair Trade Commission

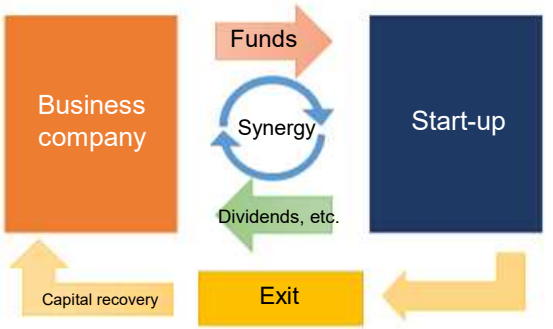
Investment agreement between a start-up and an investment fund



Source: Created by the JFTC based on the survey results.

- When a start-up receives an investment from an investor, the start-up and the investor normally conclude a continuous agreement, such as an investment agreement, with each other.
- The investment agreement provides for details on execution of investment with regard to wide-ranging items.

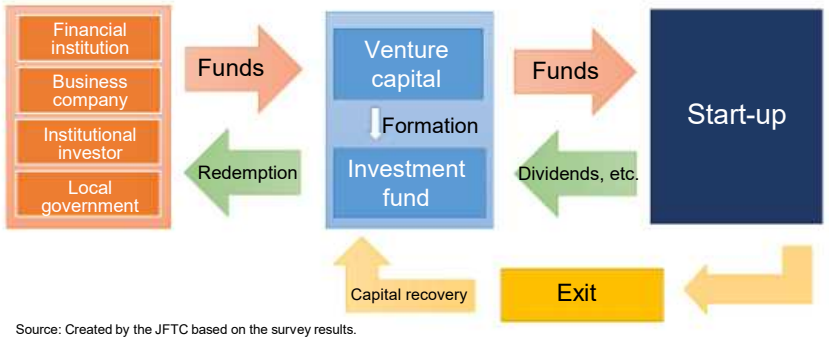
Business company



Source: Created by the JFTC based on the survey results.

- A business company is an enterprise whose main business is not investment. It often invests in a start-up when the start-up's business contents are close to its business domain, so as to achieve synergy effects with its own business.

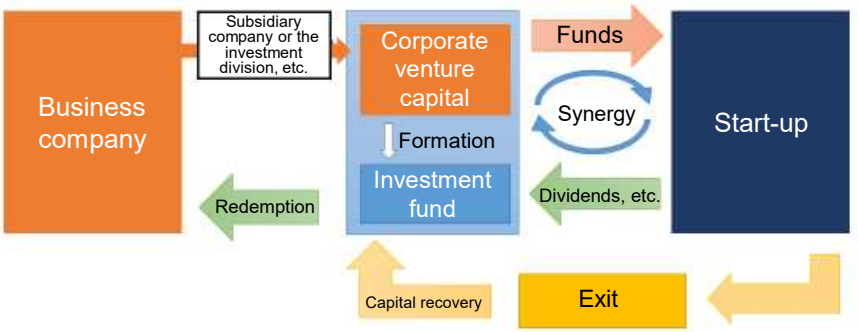
Venture capital



Source: Created by the JFTC based on the survey results.

- The main purpose of venture capital is to realize a capital gain through investment in a start-up when it is not listed on a stock market, and sale of the start-up's shares at the time of exit when its corporate value has risen.
- As for the flow of venture capital investment in a start-up, upon the investment, the venture capital firm forms a fund to execute the investment. In this process, the venture capital firm generally forms a fund by raising capital from a financial institution, etc., and investment is made by way of this fund acquiring shares of the start-up.

Corporate venture capital



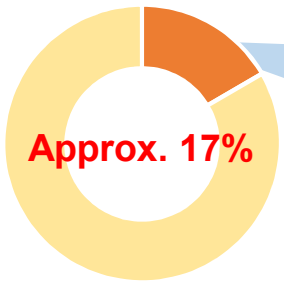
Source: Created by the JFTC based on the survey results.

- In corporate venture capital, a business company operates the venture capital with its own funds, and invests in a start-up.
- As for the flow of corporate venture capital investment in a start-up, the business company that operates the venture capital generally forms a fund by contributing capital by itself, and investment is made by way of this fund acquiring shares of the start-up.

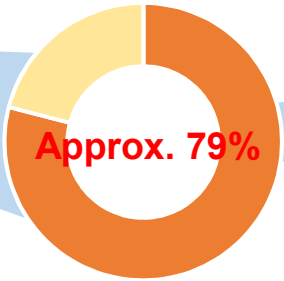
Outline of the Fact-finding Survey (Results of the Questionnaire Survey)

公正取引委員会 Japan Fair Trade Commission

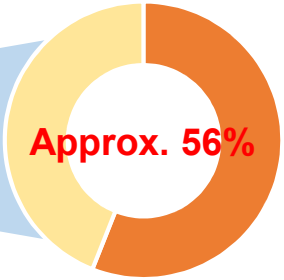
Start-ups **having experienced an unsatisfactory act** by a partner business or investor



Start-ups that **accepted the unsatisfactory act** at least in part



Start-ups that **suffered disadvantages** due to accepting the unsatisfactory act



Transaction/agreement phase in which the unsatisfactory act was experienced

Relating to an NDA	30.6%
Relating to an investment agreement	26.9%
Relating to a licensing agreement	22.7%
Relating to a joint research agreement	21.5%
Relating to a PoC agreement	18.2%

Major reason for accepting the unsatisfactory act

The trading partner did not suggest that non-acceptance would have effects on our trading (not only the trading in question, but including other ongoing and future trading), but we judged for ourselves that it would affect future trading.	44.5%
The trading partner suggested that non-acceptance would have effects on our trading (not only the trading in question, but including other ongoing and future trading), and we had no choice but to accept.	35.1%
The trading partner was an influential company in the market, and dealing with the trading partner brought large benefits when various factors were comprehensively taken into account, such as being able to gain social credibility.	28.8%
The act was alteration of terms of an already ongoing project, and there was no choice but to continue the transactions from the viewpoint of business continuity.	18.3%

Specific contents of the main disadvantage

Decline in profits	50.0%
Occurrence of unexpected costs	20.4%
Deterioration in cash flow	13.9%
Stagnation of the business speed	7.4%
Provision of intellectual property or know-how	6.5%
Loss of customers	4.6%
Development of a similar service	3.7%

Comparison of the rate of experiencing an unsatisfactory act according to the difference in the sales amount and the legal framework in start-ups

Start-ups with a sales amount of ¥50 million or more that have legal staff

Start-ups with a sales amount of less than ¥50 million that have no legal staff

The difference in the rate of experiencing an unsatisfactory act according to the difference in the sales amount and the legal framework was about 2.5 times.

Partner Business' or Investor's Bargaining Position over the Start-up

公正取引委員会 Japan Fair Trade Commission

Opinions of start-ups

High dependence on the transactions

- While running a deficit every term, we are able to make profits through the business partnership. Therefore, we are highly dependent on the partnership contract, and would inevitably accept disadvantageous contract terms rather than losing the sales altogether.

Partner business' position in the market

- The company that misappropriated our know-how was a large influential company in the market.

Possibility for changing the trading partner

- In a joint business with a partner business, we provide product design and technical know-how, and the partner business is in charge of manufacturing and selling the product. If we are to have an enterprise other than the partner business manufacture and sell the product, we need to change the product design and specifications, etc., which would require substantial costs. Therefore, it is difficult to change the trading partner.
- With regard to matters that were agreed in the negotiation for an investment agreement, the contents of the agreement were suddenly changed immediately before concluding the agreement, and terms disadvantageous for our company were added. We had no choice but to conclude an agreement under disadvantageous terms, because the negotiation took time and we ran out of sufficient business funds, and we had no time and room to change to a new investor.

Other specific facts indicating the need to conduct the transactions

(Securing of credit through transactions)

- In order for a start-up like our company to expand business, it is inevitable to conduct transactions with large companies even under terms that are disadvantageous for our company, as a record of conducting transactions with large companies enhances our credit.

(Difference in business scale)

- A start-up and a large company are so far different in business scale that the negotiating power of the large company is incomparably stronger. Moreover, due to the contract structure, while technology and know-how are provided by the start-up, the funds and resources required for their research and development are provided by the large company. Therefore, the large company's negotiating power becomes even larger(*).

  (*) The following opinion was observed as another background behind the strong negotiating power of large companies.
  At the time when a start-up is established, it focuses its resources on research and development and has no room to build a legal framework; therefore, its legal framework tends to be weak. As a result, even if a large company with a legal framework presents an agreement under terms advantageous for the large company, the start-up does not realize it at that point, and notices that it has concluded a disadvantageous agreement some time after concluding the agreement.

Principle under the Anti-Monopoly Act

- In light of the questionnaire results on the previous page and the opinions above, it is considered that, in transactions/agreements with a start-up that has experienced an "unsatisfactory act" committed by a partner business or investor, the partner business or investor is found to have a superior bargaining position over the start-up in many cases.
- Meanwhile, an act presents a problem under the Anti-Monopoly Act as an abuse of superior bargaining position when the partner business or investor has a superior bargaining position over the start-up as a premise. In addition, an act presents a problem under the Anti-Monopoly Act as an unfair trade practice such as an abuse of superior bargaining position or trading on restrictive terms, etc. when the act tends to impede fair competition(*) as a premise.

  (*) Abuse of superior bargaining position: An act which impedes the trading counterparty's transactions conducted based on its free and independent judgment, and which tends to put the trading counterparty at a competitive disadvantage against its competitors while putting the person committing the act at a competitive advantage against its competitors

  Trading on restrictive terms, etc.: Foreclosure effects (a tendency to cause the situation where new entrants to the relevant market and the enterprise's existing competitors are excluded and/or opportunities available to them are reduced as a result of making it difficult for them to easily acquire alternative trading partners), etc.

Acts Identified as Being Likely to Present a Problem under the Anti-Monopoly Act

公正取引委員会 Japan Fair Trade Commission

Transactions/ agreements between a start-up and a partner business

Acts relating to an NDA

- Disclosure of trade secrets
- Conclusion of a unilateral NDA, etc.
- Breach of an NDA

Acts relating to a PoC agreement

- Work without compensation, etc.

Acts relating to a joint research agreement

- Unilateral attribution of intellectual property rights
- Nominal joint research
- Restrictions on the use of joint research outcomes

Acts relating to a licensing agreement

- Granting of a license without compensation
- Restrictions on patent applications
- Restrictions on customers

Other acts (relating to overall agreements, etc.)

- Provision of customer information
- Reduction of consideration and delay in payment
- Unilateral bearing of liability for damages
- Restrictions on trading partners
- Most favored treatment clause

Transactions/ agreements between a start-up and an investor

- Disclosure of trade secrets
- Breach of an NDA
- Work without compensation
- Bearing of costs for business entrusted by the investor to a third party
- Purchase of unnecessary goods/services
- Appraisal rights
- Restrictions on research and development activities
- Restrictions on trading partners
- Most favored treatment clause

Relationship between a start-up and competitors

- Acts by competitors against the start-up's sales
- Acts by competitors against the start-up's purchase (procurement)

(Note) An act presents a problem under the Anti-Monopoly Act as an abuse of superior bargaining position when the partner business or investor has a superior bargaining position over the start-up as a premise.
In addition, an act presents a problem under the Anti-Monopoly Act as an unfair trade practice such as an abuse of superior bargaining position when the act tends to impede fair competition as a premise.

Supplement: Problematic Cases and Corresponding Types of Violations

[Table]

Problematic cases in transactions/agreements with partner businesses		Problematic cases in transactions/agreements with investors	
[i] Disclosure of trade secrets	Art. 2(9)(v)(b) of the Act	[xiv] Disclosure of trade secrets	Art. 2(9)(v)(b) of the Act
[ii] Conclusion of a unilateral NDA, etc.	Art. 2(9)(v)(c) of the Act	[xvii] Breach of an NDA	Para. (14) of the Public Notice
[iii] Breach of an NDA	Para. (14) of the Public Notice	[xviii] Work without compensation	Art. 2(9)(v)(b) of the Act
[iv] Work without compensation, etc.	Art. 2(9)(v)(b) or (c) of the Act	[xix] Bearing of costs for entrusted business	Art. 2(9)(v)(c) of the Act
[v] Unilateral attribution of intellectual property rights	Art. 2(9)(v)(b) of the Act	[xx] Purchase of unnecessary products/services	Art. 2(9)(v)(a) of the Act
[vi] Nominal joint research	Art. 2(9)(v)(b) of the Act	[xxi] Appraisal rights	Art. 2(9)(v)(b) or (c) of the Act
[vii] Restrictions on the use of joint research outcomes	Para. (11) or (12) of the Public Notice	[xxii] Restrictions on research and development activities	Para. (12) of the Public Notice
[viii] Granting of a license without compensation	Art. 2(9)(v)(b) of the Act	[xxiii] Restrictions on trading partners	Para. (11) or (12) of the Public Notice
[ix] Restrictions on patent applications	Art. 2(9)(v)(c) of the Act	[xxiv] Most favored treatment clause	Para. (12) of the Public Notice
[x] Restrictions on customers	Para. (11) or (12) of the Public Notice		
[xi] Provision of customer information	Art. 2(9)(v)(b) of the Act		
[xii] Reduction of consideration and delay in payment	Art. 2(9)(v)(c) of the Act		
[xiii] Unilateral bearing of liability for damages	Art. 2(9)(v)(b) of the Act		
[xiv] Restrictions on trading partners	Para. (11) or (12) of the Public Notice		
[xv] Most favored treatment clause	Para. (12) of the Public Notice		

- **Art. 2(9)(v) of the Act: Abuse of superior bargaining position**
- **Para. (11) of the Public Notice: Trading on exclusive terms**
- **Para. (12) of the Public Notice: Trading on restrictive terms**
- **Para. (14) of the Public Notice: Interference with a competitor's transactions**

(Note 1) Act: Anti-Monopoly Act; Public Notice: General Designation of Unfair Trade Practices
(Note 2) [i] to [iii] relate to an NDA, [iv] relates to a PoC agreement, [v] to [vii] relate to a joint research agreement, and [viii] to [x] relate to a licensing agreement.
(Note 3) (xix) is indicated as "Bearing of costs for business entrusted by the investor to a third party" in this report.

Source: Kuriya and Mizukami, "Regarding the Outline of the Survey Report on Business Practices of Start-ups" (NBL, no. 1187 (2021) pp. 4-)

Supplement: Types of Violations of the Anti-Monopoly Act

The Anti-Monopoly Act stipulates the basic rules which enterprises, etc. should observe in conducting business activities under free economy and society.

In order to promote fair and free competition, the Anti-Monopoly Act prohibits acts that impede free competition and competitive acts using unfair means of competition.

The main prohibited acts include the following.

1. "Private monopolization" (first part of Article 3)

An influential company putting a competitor under its control by holding shares, sending officers, etc. (control) or driving out a competitor from the market or obstructing new entry by imposing pressure on a trading partner, etc. (exclusion).

2. "Unreasonable restraint of trade" (latter part of Article 3)

Agreeing on the prices or production quantities between enterprises in the same sector or within an industrial organization so as not to compete with each other in the market. A price cartel and bid rigging fall under this type.

3. "Business combination that substantially restrains competition in the market" (Chapter 4)

Effecting a business combination (shareholdings, interlocking officers, mergers, splits, share transfers, acceptance of assignments of business, etc.) that substantially restrains competition in the market.

4. "Unfair trade practices" (Article 2, paragraph (9), items (i) to (vi) and Article 19)

For example, the following acts that tend to impede fair competition are prohibited.

- **Refusal of transactions in concert**
  …Refusing to conduct transactions with a specific enterprise in concert with a competitor, without justifiable grounds.
- **Differential pricing**
  …Unjustly supplying or receiving supply of goods at a price applied differentially between regions or between parties.
- **Unjust low price sales**
  …Without justifiable grounds, continuously supplying goods or services at a price far below the cost incurred to supply them, thereby tending to cause difficulties to the business activities of competitors.
- **Resale price restriction**
  …Without justifiable grounds, instructing a resale price to a trading partner, and making it observe that price.
- **Abuse of superior bargaining position**
  …Making use of one's superior bargaining position, and unjustly imposing a disadvantage on a trading counterparty.
- **Tie-in sales**
  …Unjustly making the counterparty purchase another product from oneself or from an enterprise one designates, in conjunction with one's supply of a product.
- **Trading on exclusive terms**
  …Unjustly conducting transactions on the condition that the counterparty does not conduct transactions with one's competitors, thereby tending to reduce the trading opportunities of one's competitors.
- **Trading on restrictive terms**
  …Conducting transactions by unjustly imposing restrictive terms with regard to the mode of sales, sales area, etc.
- **Interference with a competitor's transactions**
  …Unjustly interfering with a transaction between an enterprise which is in competition, in Japan, with one or with a corporation for which one is a shareholder or an officer and the enterprise's transaction counterparty, irrespective of whether it is done by obstructing establishment of an agreement, inducing non-performance of an agreement, or any other method.

Source: Recent Activity Status of the JFTC

Guidelines on Business Partnership Contracts with Start-ups and Investments in Start-ups

Problems concerning Non-Disclosure Agreements (NDAs)

Problems concerning Non-Disclosure Agreements (NDAs) (1)

Disclosure of trade secrets

■ There is a case in which a partner business **requests** a start-up to **disclose its trade secret without concluding an NDA**.

(Case 1) Company *A* wanted to conclude an NDA, but the partner business requested Company *A* to disclose information in advance while saying that it would conclude an agreement sometime later. Company *A* was thus forced to disclose such information as program source codes without concluding an NDA. Thereafter, their trading was suspended and the partner business announced the commencement of similar services by using Company *A*'s source codes.

(Case 2) Company *B* explained to the partner business that it would be impossible to provide all source codes, which constitute the very know-how of Company *B*'s web services. However, the partner business suggested that if Company *B* would not provide all source codes, this would exert an adverse influence on their future trading. In this manner, Company *B* was forced to provide all source codes without concluding an NDA.

Principle under the Anti-Monopoly Act

■ When a partner business that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to disclose a trade secret free of charge without concluding an NDA although there were no justifiable reasons, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act of the partner business may fall under **an abuse of superior bargaining position** (Article 2, paragraph (9), item (v) of the Anti-Monopoly Act).

Backgrounds of the problems and direction of solving them

■ As backgrounds of the problems relating to the disclosure of trade secrets, there are [i] lack of legal literacy on the side of a start-up and [ii] lack of literacy concerning open innovation.

■ Specific preventive measures for a start-up include **[i] to identify which pieces of information held by a start-up should be treated as confidential information before starting agreement negotiations on a full scale** (see the preamble of the Model Agreement [Non-Disclosure Agreement (New materials)]) and **[ii] to conclude an NDA that clarifies the purpose of use, coverage and scope of the confidential information** (see the preamble and Articles 1 to 3 of the Model Agreement [Non-Disclosure Agreement (New materials)]).

Problems concerning Non-Disclosure Agreements (NDAs) (2)

Conclusion of a unilateral NDA, etc.

■ There is a case in which a partner business **requests** a start-up **to conclude a unilateral NDA that imposes confidentiality duty and disclosure duty only on the start-up but not on the partner business (hereinafter referred to as a "unilateral NDA")** or **to conclude a short-term NDA that is not renewed automatically (hereinafter referred to as a "short-term NDA")**.

(Case 3) It was necessary for Company *C* to share important confidential information for business activities of Company *C* and the partner business for jointly carrying out business activities. However, under the concluded NDA, Company *C* was forced to disclose its trade secret while the partner business was exempt from disclosure duty.

(Case 4) Company *D* was forced to conclude an NDA that obliges Company *D* to keep confidential information of the partner business but does not oblige the partner business to keep confidential information of Company *D*.

(Case 5) Company *E* was forced to conclude a disadvantageous NDA that is not renewed automatically and whose term is very short compared to that of an ordinary NDA. After concluding the NDA, Company *E* lost contact with the partner business regarding the business partnership. Immediately after the expiration of the term of the NDA, the partner business announced the commencement of similar services.

Principle under the Anti-Monopoly Act

■ When a partner business that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to conclude a unilateral NDA or a short-term NDA one-sidedly, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act of the partner business may fall under **an abuse of superior bargaining position**.

Backgrounds of the problems and direction of solving them

■ As backgrounds of the problems relating to the conclusion of unilateral NDAs that unequally impose confidentiality duty and disclosure duty, there are [ii] lack of literacy concerning open innovation and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ Specific preventive measures for a start-up include **to conclude a bilateral NDA that imposes confidentiality duty on both parties instead of imposing duties only on either party** (see Articles 2 and 10 of the Model Agreement [Non-Disclosure Agreement (New materials)]).

Problems concerning Non-Disclosure Agreements (NDAs) (3)

Breach of an NDA

■ There is a case in which **a partner business steals a trade secret of a start-up in breach of an NDA and commences the sale of goods or the provision of services in competition with the start-up's goods or services**.

(Case 6) Company *F* concluded an NDA with the partner business. However, confidential information of the partner business was not at all disclosed, while only Company *F* had disclosed its confidential information upon request. Later, the partner business commenced the provision of similar services by the use of Company *F*'s confidential information, in breach of the NDA, and has become a competitor of Company *F*.

(Case 7) Company *G* disclosed its program source codes after concluding an NDA with the partner business. After that, it lost contact with the partner business. Then, the partner business announced the commencement of the provision of similar services and has become a competitor of Company *G*.

Principle under the Anti-Monopoly Act

■ When a partner business stole a trade secret of a start-up, in breach of an NDA, and sells goods or provides services in competition with the start-up's goods or services to the start-up's trading partners, and thereby interferes with transactions between the start-up and its trading partners, such act of the partner business may fall under **interference with a competitor's transactions** (paragraph (14) of the General Designation of Unfair Trade Practices).

Backgrounds of the problems and direction of solving them

■ As backgrounds of the breach of NDAs, there are [i] lack of legal literacy on the side of a start-up and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ Specific preventive measures for a start-up include **[i] to specifically identify confidential information in advance for proving the breach of an NDA** (see Article 1 of the Model Agreement [Non-Disclosure Agreement (New materials)]) and **[ii] to provide for the scope of liability for damages, the amount thereof and the period for making a claim in advance**.

Problems concerning Proof of Concept (PoC)

Agreements

Problems concerning Proof of Concept (PoC) Agreements (1)

Work without compensation, etc.

■ There is a case in which a start-up **cannot receive compensation for the results of a PoC** from a partner business or a start-up **is requested** by a partner business **to conduct a PoC again after completing a PoC but cannot receive compensation for the do-over**.

(Case 8) The partner business requested Company *H* to conduct a PoC for which additional work unexpected at the time of estimating the budget would be necessary, while making a verbal promise to surely conclude an agreement after the completion of the PoC. Therefore, Company *H* conducted the PoC, but could not receive compensation for the additional work, nor could it conclude an agreement with the partner business.

(Case 9) Company *I* concluded a PoC agreement for developing a trial AI system with the partner business, but the partner business said that an official system after the trial would be necessary for checking the operation of Company *I*'s products for verification. Company *I* was thus forced to do development work for its official system without compensation.

(Case 10) Company *J* conducted a PoC for developing an AI system as requested by the partner business, but was requested to do additional work after the completion of the PoC without compensation. Company *J* had no choice but to do the additional work because the PoC results would have a decisive influence on whether the company would be able to conclude a joint research agreement or have a deal with the partner business.

(Case 11) The partner business repeatedly requested Company *K* to add modifications to the completed PoC without clarifying problems. Eventually, Company *K* was forced to spend a considerable amount of money, but could receive the payment of only around one-fifth of the total cost from the partner business.

(Case 12) Company *L* had completed a PoC as instructed by the partner business, but was requested to do additional work based on newly created specifications again and again, and was forced to continue responding to such requests of the partner business.

(Case 13) Company *M* had completed a PoC as instructed by the partner business, but was requested to do additional work beyond the agreement repeatedly until the partner business became satisfied. However, Company *M* could not receive compensation commensurate with the work.

Problems concerning Proof of Concept (PoC) Agreements (2)

Principle under the Anti-Monopoly Act

■ When a partner business that has a superior bargaining position over a start-up [i] requests the start-up, a trading counterparty, to conduct a PoC free of charge without justifiable reasons, [ii] requests the start-up to conduct a PoC for a considerably small consideration one-sidedly, [iii] reduces the amount of consideration provided for in the agreement after the completion of a PoC without justifiable reasons, or [iv] requests the start-up to redo a PoC after the completion thereof without justifiable reasons, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act of the partner business may fall under **an abuse of superior bargaining position**.

Backgrounds of the problems and direction of solving them

■ As backgrounds of the problems relating to work without compensation, etc., there are [ii] lack of literacy concerning open innovation and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ Specific preventive measures for a start-up include **[i] to provide for the purpose of a PoC and the requirement for completion thereof in a business entrustment (quasi-mandate) agreement to clarify that a PoC does not guarantee the achievement of a certain outcome** (see Articles 1 to 3 and 5 of the Model Agreement [Proof of Concept (PoC) Agreement (New materials)], and Article 6 of the Model Agreement [Joint Research and Development Agreement (AI)]), **[ii] to clarify the setting of consideration for a PoC** (see Article 4 of the Model Agreement [Proof of Concept (PoC) Agreement (New materials)]), and **[iii] to clarify the conditions for shifting to joint research and development** (see Article 6 of the Model Agreement [Proof of Concept (PoC) Agreement (New materials)]).

Problems concerning Joint Research Agreements

Problems concerning Joint Research Agreements (1)

Unilateral attribution of intellectual property rights

■ There is a case in which a partner business **requests** a start-up **to conclude an agreement under which intellectual property rights based on joint research outcomes are to be attributed only to the partner business**.

(Case 14) Company *N* concluded an agreement based on the template forcibly recommended by the partner business at the time of commencing a PoC and joint research. However, under the agreement, it was provided that rights based on outcomes of a PoC and joint research would be all attributed to the partner business one-sidedly.

(Case 15) Company *O* was forced to provide its intellectual property rights to the partner business without compensation in a joint research program.

(Case 16) For Company *P*, it would become difficult to secure credit if it loses a business relationship with the partner business, which is a large company. Therefore, the partner business had a superior bargaining position when concluding a joint research agreement, and Company *P* had difficulty in making negotiations. Under such circumstances, Company *P* was requested to transfer its intellectual property rights to the partner business one-sidedly and had no choice but to accept the request.

Principle under the Anti-Monopoly Act

■ When a partner business that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to provide intellectual property rights based on joint research outcomes free of charge without justifiable reasons, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act of the partner business may fall under **an abuse of superior bargaining position**.

Backgrounds of the problems and direction of solving them

■ As backgrounds of the problems relating to unilateral attribution of intellectual property rights, there are [ii] lack of literacy concerning open innovation and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ Specific preventive measures for a start-up include **[i] to clarify the scope of background information that a start-up had held before concluding a joint research agreement, thereby preventing contamination with joint research outcomes** (see Article 2 of the Model Agreement [Joint Research and Development Agreement (New materials)]), and **[ii] to consider attributing intellectual property rights to a start-up and setting exclusive right to use with a certain limitation for a partner business, and to consider providing for the prohibition of competitive development with a third party and setting an option of a partner business's purchase of intellectual property rights in the case of a start-up's financial insecurity, while giving due consideration to the side of a partner business** (see Articles 7 and 13 of the Model Agreement [Joint Research and Development Agreement (New materials)]).

Problems concerning Joint Research Agreements (2)

Nominal joint research

■ There is a case in which **joint research was mostly conducted by a start-up, but** the start-up is **requested** by a partner business **to conclude an agreement to the effect that intellectual property rights based on joint research outcomes would be attributed only to the partner business or to both**.

(Case 17) Company *Q* was forced to conclude a one-sided agreement to the effect that patents for joint research outcomes are all attributed to the partner business, although Company *Q* conducts all work for the development of the program, which is the core of the joint research.

(Case 18) Company *R* was forced to conclude a one-sided agreement to the effect that patents for joint research outcomes are all attributed to the partner business, although Company *R* develops the program all by itself.

(Case 19) Company *S* has provided most of the technology, know-how, and idea for joint research and the partner business has made almost no contribution, but the partner business insisted that applications for patents for joint research outcomes should be filed jointly.

(Case 20) Company *T* conducts R&D activities in full and the partner business only conducts test trials of the technology developed by Company *T*. However, Company *T* was forced to conclude an agreement advantageous to the partner business to the effect that half of the rights for developed technology is to be transferred to the partner business.

Principle under the Anti-Monopoly Act

■ When a partner business that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to provide all or part of the joint research outcomes without compensation, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act of the partner business may fall under **an abuse of superior bargaining position**.

Backgrounds of the problems and direction of solving them

■ As backgrounds of the problems relating to attribution of intellectual property rights based on nominal joint research, there are [ii] lack of literacy concerning open innovation and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ Specific preventive measures for a start-up include **[i] to specify the details of division of roles in advance** (see Article 3 of the Model Agreement [Joint Research and Development Agreement (New materials)]), and **[ii] to set appropriate returns in accordance with the contribution to the creation of joint research outcomes** (see Article 5 of the Model Agreement [Joint Research and Development Agreement (New materials)]).

Problems concerning Joint Research Agreements (3)

Restrictions on the use of joint research outcomes

■ There is a case in which **restrictions on customers for goods or services based on joint research outcomes or restrictions on customers for goods or services newly developed based on joint research experience are imposed** on a start-up by a partner business.

(Case 21) When Company *U* intended to introduce services that it had developed all by itself, the partner business instructed Company *U* not to sell the services to any other competitors, while stating that otherwise it would pull out of deal. Company *U* had no choice but to accept the instruction.

(Case 22) The AI improved by Company *V* based on the experience of business partnership with the partner business was originally developed by Company *V* independently and contains no material information of the partner business. Nevertheless, the partner business requested Company *V* not to sell the AI to other enterprises.

Principle under the Anti-Monopoly Act

■ When a partner business, which is an influential enterprise in the market, imposes restrictions on a start-up, a trading counterparty, regarding customers for goods or services based on joint research outcomes or customers for goods or services newly developed based on joint research experience, without limiting a reasonable period of time, and there is a risk that such restrictions may have foreclosure effects, such act of the partner business may fall under **trading on exclusive terms** (paragraph (11) of the General Designation of Unfair Trade Practices) or **trading on restrictive terms** (paragraph (12) of the General Designation of Unfair Trade Practices).

Backgrounds of the problems and direction of solving them

■ As backgrounds of the problems relating to restrictions on the use of joint research outcomes, there are [ii] lack of literacy concerning open innovation and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ Specific preventive measures for a start-up include to **attribute intellectual property rights to a start-up and set exclusive right to use with a certain limitation for a partner business** (see Articles 7 and 13 of the Model Agreement [Joint Research and Development Agreement (New materials)]).

Supplement: "Influential Enterprise in the Market" and "Foreclosure Effects"

■ **Influential enterprise in the market**

Vertical restraints contain those that are found illegal as unfair trade practices when having been conducted by an influential enterprise in the market. Types of acts mentioned later in Section 2 (Restriction on Dealings with Competitors, etc.), Section 3, Sub-Section (3) (Strict territorial restriction) and Section 7 (Tie-in Sales) of Chapter 2 fall under such vertical restraints.

Whether a business is found to fall under an influential enterprise in the market is judged by a market share, that is, **whether or not it has a share exceeding 20% in the market** (meaning a product market which consists of a group of products with the same or similar functions and utility as the product subject to the restraint that are in a competitive relationship, judging from geographical conditions, transactional relations and other factors, and which is determined, in principle, in terms of substitutability for users and also, when necessary, substitutability for suppliers). Nevertheless, even if an enterprise falls under this criterion, a restraint by the enterprise is not always illegal. Such restraint is illegal if it has "foreclosure effects" or "price maintenance effects."

In cases where an enterprise which has a market share of 20% or less or a new entrant commits any of these acts, this does not usually tend to impede fair competition and therefore is not illegal.

■ **Cases where vertical restraints have foreclosure effects**

"Cases where vertical restraints have foreclosure effects" refer to cases where a vertical non-price restraint (note: an act to restrict a trading partner's handling products, sales territory, customers, etc.) tends to cause a situation where **new entrants to the relevant market and the enterprise's existing competitors are excluded and/or opportunities available to them are reduced** as a result of **making it difficult for them to easily acquire alternative trading partners** and causing an increase of their expenses for conduct of business and/or their discouragement from entering the market or developing new products.

Whether a particular vertical restraint has foreclosure effects should be determined in accordance with the guidance on the criteria for judging legality or illegality as set forth in Sub-Section (1) above. For example, if an enterprise which imposes a vertical non-price restraint holds a stronger position in a market, the restraint is more likely to have foreclosure effects. Such determination should also be made by taking into account other enterprises' acts. For example, if two or more enterprises impose vertical non-price restraints respectively and in parallel, those restraints are more likely to have foreclosure effects on the market as a whole than in the case where a single enterprise imposes a vertical non-price restraint.

When determining whether a particular vertical restraint has foreclosure effects, the restraint is not required to cause any tangible situation as mentioned above.

Source: Guidelines concerning Distribution Systems and Business Practices under the Anti-Monopoly Act

Problems concerning Licensing Agreements

Problems concerning Licensing Agreements (1)

Granting of a license without compensation

■ There is a case in which a partner business **requests** a start-up **to grant a license for an intellectual property right without compensation**.

(Case 23) Company *W* decided to grant a license for its technology to the partner business to have it sell the products but was forced to grant the license without compensation.

Principle under the Anti-Monopoly Act

■ When a partner business that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to grant a license for an intellectual property right free of charge without justifiable reasons, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act of the partner business may fall under **an abuse of superior bargaining position**.

Backgrounds of the problems and direction of solving them

■ Many of the cases in which a licensing agreement that is extremely advantageous to either party is concluded are considered to be caused by [i] lack of legal literacy on the side of a start-up and [ii] lack of literacy concerning open innovation.

■ Specific preventive measures for a start-up include **[i] to clarify the coverage, term, area of a license and the scopes of exclusive license and non-exclusive license** (see Article 2 of the Model Agreement [Licensing Agreement (New materials)]), and **[ii] to set license fees by broadly examining individual cases depending on the scarcity and significance of a patent, market size, prices, product lifetime, level of contribution of the patent, etc.** (see Article 4 of the Model Agreement [Licensing Agreement (New materials)]).

Problems concerning Licensing Agreements (2)

Restrictions on patent applications

■ There is a case in which a partner business **imposes restrictions** on a start-up **regarding patent applications for technologies that the startup had developed and granted a license therefor to the partner business**.

(Case 24) The partner business requested Company *X* to conclude an agreement containing a clause to prohibit Company *X* from obtaining patents for any of the know-how and technologies that it independently develops in the process of developing software as entrusted by the partner business. Company *X* was forced to conclude the agreement.

(Case 25) Company *Y* had conducted joint research with the partner business, but the partner business decided one-sidedly that they should discuss the attribution of the rights for new technologies that Company *Y* develops in its research independent of the joint research, including the possibility of joint patent applications, and added a clause to prohibit Company *Y* from solely filing patent applications in the joint research agreement.

Principle under the Anti-Monopoly Act

■ When a partner business that has a superior bargaining position over a start-up imposes restrictions on the start-up, a trading counterparty, one-sidedly regarding patent applications for technologies that the start-up developed, and the start-up has no choice but to accept the restrictions in fear of any adverse influence on their future trading, such act of the partner business may fall under **an abuse of superior bargaining position**.

Backgrounds of the problems and direction of solving them

■ Many of the cases in which restrictions on patent applications are imposed in a licensing agreement are considered to be caused by [ii] lack of literacy concerning open innovation and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ Specific preventive measures for a start-up include **to clarify the theme of the joint research and development in order to make it possible to clearly distinguish whether any newly invented intellectual property right is a joint research outcome or not, thereby clarifying inventors** (see Article 1 of the Model Agreement [Joint Research and Development Agreement (New materials)]).

Problems concerning Licensing Agreements (3)

Restrictions on customers

■ There is a case in which a partner business **restricts** a start-up's **sale of its goods or services to other enterprises, etc.**

(Case 26) Company *Z* depends on the partner business for both funds and data in developing its services. Company *Z* was forced to conclude an exclusive agreement that prohibits Company *Z*'s provision of services, even those not including the partner business's data, to any enterprises, etc. other than the partner business.

(Case 27) Company *a* was forced to conclude an exclusive distributorship agreement that does not allow Company *a* to conduct sales activities and imposes a penalty if it breaches this term of the agreement.

Principle under the Anti-Monopoly Act

■ When a partner business, which is an influential enterprise in the market, prohibits a start-up, a trading counterparty, from selling its goods or services to other enterprises or restricts the start-up's own sales activities beyond a reasonable extent, and there is a risk that such prohibition or restrictions may have foreclosure effects, such act of the partner business may fall under **trading on exclusive terms** or **trading on restrictive terms**.

Backgrounds of the problems and direction of solving them

■ Many of the problems relating to restrictions on customers are considered to be caused by [ii] lack of literacy concerning open innovation and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ Specific preventive measures for a start-up include **to set a license after making adjustments while considering ideal restrictions on the scope of sales for both parties to mutually maximize profits in light of differences in their business models** (see Article 7 of the Model Agreement [Joint Research and Development Agreement (New materials)]).

Other Problems (concerning Overall Business Partnership Contracts, etc.)

Other Problems (concerning Overall Business Partnership Contracts, etc.) (1)

Provision of customer information

■ Customer information of a start-up falls under a trade secret but is often excluded from the coverage of an NDA, and there is a case in which a start-up is **requested to provide its customer information** by a partner business.

(Case 28) Company *b* was requested to provide its customer information by the partner business and was forced to accept that request. As a result, the partner business started to sell products competing with Company *b*'s products to Company *b*'s customers.

(Case 29) In a cooperative business with the partner business, Company *c* was forced to provide information on its customers, which falls under a trade secret, to the partner business, but the partner business did not disclose its information at all.

Principle under the Anti-Monopoly Act

■ When a partner business that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to provide its customer information free of charge without justifiable reasons, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act of the partner business may fall under **an abuse of superior bargaining position**.

Backgrounds of the problems and direction of solving them

■ Problems relating to provision of customer information are considered to be caused by [i] lack of legal literacy on the side of a start-up and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ It is important to take measures to protect customer information as a trade secret, and specific preventive measures for a start-up include **[i] to develop an internal management system to protect customer information as a trade secret under the Unfair Competition Prevention Act** and **[ii] to provide for confidentiality duty and prohibition of use for other purposes in an NDA, etc.** (see the preamble and Articles 1 to 3 of the Model Agreement [Non-Disclosure Agreement (New materials)]).

Other Problems (concerning Overall Business Partnership Contracts, etc.) (2)

Reduction of consideration and delay in payment

■ There is a case in which a partner business **reduces the amount of consideration** for a start-up or **defers payment of consideration**.

(Case 30) Under a joint research agreement concluded with the partner business, Company *d* was to receive the predetermined amount of money over several years, but during the term of the agreement, the partner business reduced the amount of consideration one-sidedly without justifiable reasons.

(Case 31) The partner business insisted to conclude an agreement without determining the amount of consideration for Company *e*, while presenting a specific amount of money separately. Therefore, Company *e* concluded the agreement and conducted work. However, the partner business said that the work became unnecessary and one-sidedly reduced the amount that it had presented in advance on the ground that the amount of consideration was not stated in the written agreement.

(Case 32) In a final phase of work entrusted by the partner business, Company *f* was suddenly requested to guarantee the performance, quality, accuracy, etc. of the product. Although Company *f* had told the partner business that it would be difficult to guarantee these matters before concluding the agreement, the partner business reduced the amount of consideration on the ground that Company *f* cannot give a guarantee.

(Case 33) Under an agreement, Company *g* was to receive advance payment for some products that it delivers to the partner business, but the partner business deferred payment.

Principle under the Anti-Monopoly Act

■ When a partner business that has a superior bargaining position over a start-up [i] reduces the amount of consideration determined in an agreement without justifiable reasons, or [ii] does not pay consideration by the payment date determined in an agreement without justifiable reasons, and the start-up has no choice but to accept the reduction or the delay in payment in fear of any adverse influence on their future trading, such act of the partner business may fall under **an abuse of superior bargaining position**.

Backgrounds of the problems and direction of solving them

■ Problems regarding consideration, such as that the alteration or abrogation of agreed terms is imposed or the amount of consideration that was to be later consulted on as stated in a written agreement is reduced one-sidedly, are considered to be caused by [ii] lack of literacy concerning open innovation and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ Specific preventive measures for a start-up include **[i] to set the payment terms and the amount of consideration clearly at the time of concluding an agreement** (see Article 10 of the Model Agreement [Joint Research and Development Agreement (New materials)]), and **[ii] to clarify whether it is necessary to guarantee the quality of the product, etc. in advance** (see Article 5 of the Model Agreement [Proof of Concept (PoC) Agreement (New materials)]).

Other Problems (concerning Overall Business Partnership Contracts, etc.) (3)

Unilateral bearing of liability for damages

■ There is a case in which a partner business **requests a start-up to conclude an agreement that requires only the start-up to bear liability for damages for goods or services based on joint business outcomes**.

(Case 34) The partner business unilaterally decided that in the event of any failure in products with a system that Company *h* developed and delivered to the partner business, Company *h* should bear liability for damages in full, irrespective of causes of the failure, while the partner business will not bear liability.

(Case 35) Company *i* wanted to conclude an agreement under which it bears liability up to the amount of trading with the partner business, but was forced to accept an agreement that requires Company *i* to take all risks, due to its weak bargaining position.

(Case 36) Company *j* was forced to bear liability for damages at an amount several to tens of times the trading amount by the partner business.

Principle under the Anti-Monopoly Act

■ When a partner business that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to solely bear liability for damages for goods or services based on joint business outcomes without justifiable reasons, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act of the partner business may fall under **an abuse of superior bargaining position**.

Backgrounds of the problems and direction of solving them

■ Cases in which liability for damages is imposed unilaterally on either party are considered to be often caused by [i] lack of legal literacy on the side of a start-up and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ Specific preventive measures for a start-up include **[i] to limit the conditions for patent guarantee, such as providing that it suffices to only declaring "there is no infringement of right as far as *X* knows"** (see Article 9 of the Model Agreement [Joint Research and Development Agreement (New materials)]), and **[ii] to limit the amount of compensation for damage in accordance with the means of a start-up** (see Article 10 of the Model Agreement [Proof of Concept (PoC) Agreement (New materials)]).

Other Problems (concerning Overall Business Partnership Contracts, etc.) (4)

Restrictions on trading partners

■ There is a case in which a partner business **imposes restrictions** on a start-up **regarding trading (sale, purchase, etc.) with other enterprises**.

(Case 37) When concluding a business partnership contract with the partner business, Company *k* resisted the partner business's request not to deal in products of other enterprises, but had no choice but to accept the request because it could not find any other business tie-up partner.

Principle under the Anti-Monopoly Act

■ When a partner business, which is an influential enterprise in the market, prohibits a start-up, a trading counterparty, from selling its goods or services to other enterprises beyond a reasonable extent, and there is a risk that such prohibition may have foreclosure effects, such act of the partner business may fall under **trading on exclusive terms** or **trading on restrictive terms**.

Backgrounds of the problems and direction of solving them

■ Problems relating to restrictions on trading partners are considered to be often caused by [ii] lack of literacy concerning open innovation and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ Specific preventive measures for a start-up include **to restrict trading partners after adjusting interests between the parties** (see Articles 7 and 13 of the Model Agreement [Joint Research and Development Agreement (New materials)]).

Other Problems (concerning Overall Business Partnership Contracts, etc.) (5)

Most favored treatment clause

■ There is a case in which a partner business **sets a most favored treatment clause (a clause to require a start-up to set business terms for a partner business equal to or superior to those for other trading partners)** in an agreement with a start-up.

(Case 38) Company *l* was forced to accept a business term that it would set sales prices of the products lowest for the partner business compared with those for other enterprises.

(Case 39) Company *m* provides services to multiple partner businesses, but one of the partner businesses forced Company *m* to set service prices lowest for it compared with those for the other partner businesses.

(Case 40) Company *n* was forced by the partner business to make the partner business most prominent in the media operated by Company *n* and to set business terms for the partner business equal to or superior to those for other enterprises that operate similar media.

Principle under the Anti-Monopoly Act

■ When a partner business, which is an influential enterprise in the market, sets a most favored treatment clause in an agreement with a start-up, a trading counterparty, and there is a risk that such clause makes it difficult for its competitors to have a deal with the start-up on more favorable terms and reduces those competitors' incentives for a deal, thereby impeding competition between the partner business and those competitors and resulting in having foreclosure effects, such act of the partner business may fall under **trading on restrictive terms**.

Backgrounds of the problems and direction of solving them

■ Problems relating to the setting of a most favored treatment clause are considered to be often caused by [ii] lack of literacy concerning open innovation and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ Specific preventive measures for a start-up include **to set a most favored treatment clause after properly adjusting interests** (see Article 8 of the Model Agreement [Use Agreement (AI)]).

Problems concerning Transactions/Agreements with Investors

Disclosure of Trade Secrets

Disclosure of trade secrets

■ There is a case in which an investor requires a start-up to disclose its trade secret without concluding an NDA.

[Case 41] Company *o* was refused by an investor to conclude an NDA, and being strongly requested to explain its business model that includes trade secrets to the investor, Company *o* explained the contents of the business model to the investor.

[Case 42] In order to enable an investor to internally manufacture Company *p*'s product, Company *p* was forced to disclose, free of charge, its know-how on the entire manufacturing process beyond the contents of their investment agreement.

Principle under the Anti-Monopoly Act

■ When an investor that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to disclose a trade secret free of charge without concluding an NDA although there are no justifiable reasons, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act of the investor may fall under an **abuse of superior bargaining position**.

Backgrounds of the problems and direction of solving them

■ As backgrounds of the problems, there are [i] lack of contract/legal literacy on the side of a start-up and [ii] lack of literacy concerning open innovation on the side of an investor.

■ As for the direction of solving the problems, measures could be taken **[i] to identify confidential information in advance** and **[ii] to conclude an NDA that clarifies the purpose of use, coverage and scope of the confidential information**.

Breach of an NDA

Breach of an NDA

■ There is a case in which an investor leaks a trade secret of a start-up, such as a business idea, to another investee in breach of an NDA and that other investee commences the sale of goods or the provision of services in competition with the start-up's goods or services.

[Case 43] As an investor requested Company *q* to disclose its confidential information in business to the investor as a condition for investment, Company *q* disclosed the information after concluding an NDA with the investor. However, the investor leaked the confidential information to another investee, which is an enterprise that could become Company *q*'s competitor, in breach of the NDA. As a result, that enterprise developed and commenced provision of services in competition with Company *q*'s services.

Principle under the Anti-Monopoly Act

■ When an investor leaks a trade secret of a start-up to another investee, in breach of an NDA, and that investee sells goods or provides services in competition with the start-up's goods or services to the start-up's trading partners, and thereby interferes with trading between the start-up and its trading partners, such act of the investor may fall under **interference with a competitor's transactions**.

Backgrounds of the problems and direction of solving them

■ As backgrounds of the problems, there are [i] lack of contract/legal literacy on the side of a start-up and [ii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ As for the direction of solving the problems, measures could be taken **[i] to specifically identify confidential information in advance for proving the breach of an NDA** and **[ii] to provide for liability for damages**.

Work without Compensation

Work without compensation

■ There is a case in which a start-up is requested by an investor to do work that is not provided for in the agreement free of charge.

[Case 44] When an investor was launching a new business of its own, Company *r* was requested by the investor to do work beyond the scope decided under the agreement free of charge, in order to promote the new business. As Company *r* was in a difficult position to negotiate as it had future trading planned with the investor, it was compelled to actually do work free of charge although the work brought no benefits to Company *r*.

Principle under the Anti-Monopoly Act

■ When an investor that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to do work that is not provided for in the agreement free of charge without justifiable reasons, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act of the investor may fall under an **abuse of superior bargaining position**.

Backgrounds of the problems and direction of solving them

■ As backgrounds of the problems, there are [ii] lack of literacy concerning open innovation on the side of an investor and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ As for the direction of solving the problems, both parties should adjust the work, etc. that arises, in accordance with the managing conditions of the start-up, for example.

Bearing of Costs for Business Entrusted by the Investor to a Third Party

Bearing of costs for business entrusted by the investor to a third party

■ There is a case in which a start-up is requested by an investor to bear all costs relating to work which the investor entrusted to a third party.

[Case 45] Company *s* was requested to bear all costs for work which an investor entrusted to an outside party, and had no choice but to pay for the costs. The costs should have been borne by the investor in nature.

Principle under the Anti-Monopoly Act

■ When an investor that has a superior bargaining position over a start-up unilaterally requests the start-up, a trading counterparty, to bear all costs relating to work which the investor entrusted to a third party, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act of the investor may fall under an **abuse of superior bargaining position**.

Backgrounds of the problems and direction of solving them

■ As backgrounds of the problems, there are [i] lack of contract/legal literacy on the side of a start-up and [ii] lack of literacy concerning open innovation on the side of an investor.

■ As for the direction of solving the problems, both parties should have a common understanding of the costs to be borne, after adjusting and discussing the contents of the investigation for investment screening, for example.

Purchase of Unnecessary Goods/Services

Purchase of unnecessary goods/services

■ There is a case in which a start-up is requested by an investor to purchase unnecessary goods/services from an enterprise designated by the investor, including another investee.

[Case 46] Company *t* already had a back office expert, and did not need a new expert. However, Company *t* was instructed by an investor to use an expert who was affiliated with the investor, and was unilaterally forced to bear personnel costs.

[Case 47] Company *u* was requested by an investor to place an order for work that was completely unnecessary for executing the relevant business with an enterprise which was another investee of the investor, and suffered a loss in the amount of the costs for that unnecessary work.

Principle under the Anti-Monopoly Act

■ When an investor that has a superior bargaining position over a start-up requests the start-up, a trading counterparty, to purchase goods/services other than those relating to the transaction in question, and although the goods/services are unnecessary for executing the relevant business or the start-up does not want to purchase them, the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act of the investor may fall under an **abuse of superior bargaining position**.

Backgrounds of the problems and direction of solving them

■ As backgrounds of the problems, there are [i] lack of contract/legal literacy on the side of a start-up and [ii] lack of literacy concerning open innovation on the side of an investor.

■ As for the direction of solving the problems, when a start-up purchases goods/services on referral from an investor, the parties should make adjustments and have a common understanding on whether they are necessary for the start-up's work and other matters.

Appraisal Rights (1)

Disadvantageous request backed by appraisal rights

■ [i] There is a case in which a start-up receives a disadvantageous request from an investor, such as a request for transfer of an intellectual property right free of charge, and it is suggested that the investor would exercise appraisal rights if the start-up does not accept the request.

[Case 48] Company *v* was steadily conducting business and achieved the business plan goal that had been agreed with the investor. However, Company *v* received a request from the investor to transfer its intellectual property right free of charge, and because it was suggested that the investor would exercise appraisal rights if it does not accept the request, Company *v* transferred the intellectual property right to the investor.

Establishment of entitlement to appraisal rights based on which the purchase may be demanded at an extremely high price

■ [ii] There is a case in which a start-up whose business funds are depleting is requested by an investor to establish entitlement to appraisal rights based on which the purchase may be demanded at a price extremely higher than the investment amount.

[Case 49] In an agreement between Company *w* and an investor, the investor established a condition that enables the investor to exercise appraisal rights even in the case of a minor breach of agreement on Company *w*'s side, and unilaterally established a condition that enables the investor to demand the purchase at a price extremely higher than the investment amount.

[Case 50] Company *x* was forced to accept a condition by an investor that Company *x* must buy back shares at a price extremely higher than the investment amount a few years later.

Exercise of appraisal rights when the conditions for exercise are not met

■ [iii] There is a case in which an investor exercises appraisal rights against a start-up for a part of the shares held by the investor, even if the conditions for the exercise of the rights are not met.

[Case 51] Company *y* changed the method of equipment procurement so that it can sell its product at a lower price. This change was not categorized as a material change to the business plan and therefore the conditions for exercise of the appraisal rights were not met, but an investor unilaterally exercised the appraisal rights for a part of the shares.

Appraisal Rights (2)

Principle under the Anti-Monopoly Act

- Appraisal rights may **enhance** the investor's **bargaining position** against the start-up in that it enables the investor to gain an advantage in the negotiation by, for example, suggesting a possibility of exercising the rights to the start-up ([i]). In addition, the establishment or exercise of appraisal rights may cause a **significant disadvantage** for a start-up depending on their contents and method ([ii] and [iii]).
- [i] When an investor that has a superior bargaining position over a start-up makes a disadvantageous request to the start-up, a trading counterparty, such as a request for transfer of an intellectual property right free of charge, without justifiable grounds, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act of the investor may fall under an **abuse of superior bargaining position**.
- [ii] When an investor that has a superior bargaining position over a start-up makes a unilateral request to the start-up, a trading counterparty, to establish entitlement to appraisal rights based on which the purchase may be demanded at a price extremely higher than the investment amount, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act of the investor may fall under an **abuse of superior bargaining position**.
- [iii] When an investor that has a superior bargaining position over a start-up demands that the start-up, a trading counterparty, purchase a part of the shares held by the investor without justifiable grounds, and the start-up has no choice but to accept the request in fear of any adverse influence on their future trading, such act of the investor may fall under an **abuse of superior bargaining position**.

Backgrounds of the problems and direction of solving them

- As backgrounds of the problems, there are [ii] lack of literacy concerning open innovation on the side of an investor and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.
- As for the direction of solving the problems, measures could be taken **[i] to ensure that investors do not abuse appraisal rights** and **[ii] to clearly limit the conditions for exercise of the rights to a material breach of a rep and warranty and a material breach of an agreement**.

Appraisal Rights (3)

Appraisal rights which may be exercised against individuals

■ There is a case in which a start-up is requested by an investor to establish entitlement to appraisal rights which may be exercised against an individual, such as a managing shareholder of the start-up.

[Case 52] Company *z* was requested by an investor to provide for entitlement to appraisal rights which may be exercised against the founder of the company in the investment agreement, and such right was unilaterally provided for in the agreement.

[Case 53] In an agreement between Company *AA* and an investor, the investor unilaterally established a condition that enables the investor to exercise appraisal rights against the founder of the company if Company *AA* implements business without the consent of the investor.

Principle under the competition policy

■ From the viewpoint of enhancing start-ups' entrepreneurial motivation and promoting open innovation and employment, it is desirable in terms of competition policy **to exclude individuals, such as managing shareholders, from those against whom appraisal rights may be exercised, even in the case of providing for appraisal rights in an investment agreement**.

Backgrounds of the problems and direction of solving them

■ As backgrounds of the problems, there are [ii] lack of literacy concerning open innovation on the side of an investor and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ As for the direction of solving the problems, in light of the need to respond to global standards, **the party against whom appraisal rights may be exercised at the time of a breach of an agreement should be limited to the issuing company, and should exclude individuals, such as managing shareholders**.

Restrictions on Research and Development Activities

Restrictions on research and development activities

■ There is a case in which a start-up is prohibited by an investor from conducting research and development activities for new products, etc.

[Case 54] Company *BB* intended to start development of artificial intelligence (AI) applying Company *BB*'s technology. However, as an investor prohibited the development due to the reason that the AI may compete with AI of another investee, and told Company *BB* that the investor would terminate the investment agreement if Company *BB* did not observe the prohibition, Company *BB* had to give up the development.

Principle under the Anti-Monopoly Act

■ An investor's act to restrict a start-up's free research and development activities, such as prohibiting the start-up, a trading counterparty, from conducting research and development by itself or jointly with a third party in relation to technology that competes with technology held by the investor or another investee, generally has a risk of diminishing competition in the future technology market or market of goods, etc. through its influence on competition over research and development. Accordingly, such act of the investor is highly likely to fall under **trading on restrictive terms**.

Backgrounds of the problems and direction of solving them

■ As backgrounds of the problems, there are [ii] lack of literacy concerning open innovation on the side of an investor and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ As for the direction of solving the problems, **for start-ups having diverse growth potential, restrictions on research and development activities are highly likely to impede business expansion, and are basically considered to be undesirable**.

Restrictions on Trading Partners

Restrictions on trading partners

■ There is a case in which a start-up is restricted by an investor from partnering with or otherwise dealing with another enterprise or from receiving investments from another investor.

[Case 55] Company *CC* was not only prohibited by an investor that also conducts businesses other than investment from partnering with enterprises that are in competition with the investor, but was also restricted from dealing with all enterprises that are not in competition with the investor.

[Case 56] Company *DD* concluded an exclusive agreement with an investor with a promise to conduct joint business with the investor in the future. However, no joint business was commenced after that. Also, the investor did not respond to a request to revise the exclusive agreement, and put Company *DD* in a state of not being able to partner with any another enterprise even if it wanted to.

[Case 57] Company *EE* was imposed with wide-ranging restrictions under an investment agreement, such as not to procure funds from another company, not to conduct transactions with another company, and not to form a business partnership with another company without advance permission from the investor.

[Case 58] It became virtually impossible for Company *FF* to receive investments from a new investor, because an existing investor added an agreement term to the effect that the business terms between the investor and Company *FF* would be changed to those that are considerably disadvantageous for Company *FF* if Company *FF* received investments from a new investor.

Principle under the Anti-Monopoly Act

■ When an investor, which is an influential enterprise in the market, prohibits a start-up, a trading counterparty, from dealing with other enterprises beyond a reasonable extent, and there is a risk that the prohibition may have foreclosure effects, such act of the investor may fall under **trading on exclusive terms** or **trading on restrictive terms**.

Backgrounds of the problems and direction of solving them

■ As backgrounds of the problems, there are [ii] lack of literacy concerning open innovation on the side of an investor and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ As for the direction of solving the problems, a possible option after both parties adjust their interests in consideration of future business expansion of the start-up is to have a common understanding of whether the restriction functions reasonably.

Most Favored Treatment Clause

Most favored treatment clause

■ There is a case in which an investor sets a most favored treatment clause (a clause to require a start-up to set business terms for an investor equal to or superior to those for other investors) in an agreement with a start-up.

[Case 59] An investor set a most favored treatment clause in an agreement with Company *GG* providing that, if another investor concludes an investment agreement with Company *GG* on more favorable terms in the future, the same terms will be applied to the investor. As a result, Company *GG* no longer received offers for investments from other investors.

[Case 60] An existing investor set a most favored treatment clause for the investor in an agreement wtih Company *HH*. Another investor that was considering making additional investment in Company *HH* did not make the additional investment in the end due to the existence of the most favored treatment clause.

Principle under the Anti-Monopoly Act

■ When an investor, which is an influential enterprise in the market, sets a most favored treatment clause in an agreement with a start-up, a trading counterparty, and there is, for example, a risk that such clause makes it difficult for its competitors to have a deal with the start-up on more favorable terms and reduces those competitors' incentives for a deal, thereby impeding competition between the investor and those competitors and resulting in having foreclosure effects, such act of the investor may fall under **trading on restrictive terms**.

Backgrounds of the problems and direction of solving them

■ As backgrounds of the problems, there are [ii] lack of literacy concerning open innovation on the side of an investor and [iii] existence of unwanted practices for promoting open innovation premised on an equal footing.

■ As for the direction of solving the problems, a possible option after both parties adjust their interests in anticipation of the direction of the start-up's future fund procurement is to have a common understanding of whether the most favored treatment clause functions reasonably.