



Recent Developments in Japanese Law Concerning Employee Inventions

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I Introduction

Today, most inventions are developed not by the unaffiliated individual inventor toiling alone in his garage, but rather by employees of organizations, private companies, academic institutions, and governments in the course of or in connection with the employees' performance of duties to such organizations. As such, the law addressing employee inventions, including the rules related to ownership of the inventions, the employer's right to use such inventions, and the regulation of the transfer or licensing of such inventions, is one of the most important areas of law for modern industrial societies.

This area of law is also challenging because it is the intersection between intellectual property law and labor law, as well as between property law and contract law. In this article, I intend to provide a brief description of the recent developments in Japanese case law in this area, particularly with regard to the requirement that due consideration be paid for the transfer of an employee invention. As discussed below, Japanese statutory framework in this field is somewhat unique as compared with that of the rest of the industrialized world; the recent case law has developed within that framework. This article will also introduce recent amendments to the relevant statutory provisions, which amendments were enacted in response to the described case law developments.

II Overview of Current Rules under the Japanese Patent Law

Article 35 of the Patent Law ¹⁾ sets forth the rules governing employee inventions. ²⁾ Paragraph 1 of the said Article in essence provides that an employer (be it an individual, enterprise, government, or otherwise) shall have a statutory, non-exclusive, royalty-free license for all patented inventions developed by an employee in the course of his employment, provided that such inventions are within the scope of the employer's business (hereinafter "course-of-employment invention"). The premise is that the right to such an invention vests in the inventor employee. The inventor employee thus has the right to apply for a patent for a course-of-employment invention. If the patent is granted, the employee will be the patentee and will have the exclusive right to use the patent. However, in light of the fact that corporate resources, financial or otherwise, are generally used by the inventor employee in the development of the course-of-employment invention, the law grants the employer a statutory license to use the patent.

1) Law No. 121 of 1959, as amended.

2) The same rules are adopted in the Design Patent Law and Utility Patent Law by referencing Article 35 of the Patent Law, *mutatis mutandis*.

Paragraph 2 of Article 35 declares that, as to an employee invention other than a course-of-employment invention, all arrangements set forth in the relevant contracts, work rules or otherwise that transfer the ownership of a patent or the right to apply for such a patent or that force the employee to grant the employer a sole and exclusive license (Senyou-Jisshiken) to use the patent are invalid. This provision is intended to protect an employee from being exploited by his employer. However, an employer is permitted to adopt rules or enter into contract with the employee under which the employee is required to transfer ownership of the course-of-employment invention in advance or grant an exclusive license in advance to the employer to use the patent. As such, most companies adopt intra-company rules (hereinafter "intra-company invention rules"), such as work rules, or other intra-company regulations, which require, in advance, the employees to transfer all right to any future course-of-employment inventions.

Paragraph 3 provides that the employee is entitled to receive "due consideration" for the transfer of ownership or the grant of a sole and exclusive license in favor of the employer for the course-of-employment invention.

Paragraph 4 sets forth the factors that need to be considered in the determination of the amount of due consideration to be paid under Paragraph 3, including: (1) the benefit to be enjoyed by the employer as a result of the subject course-of-employment invention; and (2) the employer's contribution to the creation of such invention.

Paragraphs 3 and 4 are also said to be designed to protect employee interests against exploitation by employers. As these provisions are interpreted as mandatory provisions, neither employer nor employee can dispense with the due consideration requirement through an agreement.

Paragraphs 3 and 4, which make it mandatory for an employer to pay due consideration for the transfer of the right to a course-of-employment invention, are rather peculiar in light of the rules applied in other jurisdictions. For example, in the United States, disposition of the right to the course-of-employment invention as well as the consideration therefor are matters to be freely disposed of by agreements between the employer and the employee, subject to the general common law consideration requirement. In the United Kingdom, the right to a course-of-employment invention generally vests in an employer rather than employee; the employee is entitled to compensation only when the employer receives an outstanding benefit from the invention. It has been reported that there have been few employee inventions that have met the "outstanding benefit" criteria. While Germany has adopted a framework similar to that of Japan, Germany's law sets forth a detailed compensation evaluation and calculation formula, whereas the Japanese law merely states

that "due consideration" is to be paid, while giving few clues for the method to be used in the actual evaluation of same.³⁾

It is in relation to these Paragraphs 3 and 4 that controversy concerning a series of court rulings regarding due consideration has arisen in certain cases in which the courts have ordered employers to pay consideration beyond that prescribed in the relevant intra-company invention rules.

III Recent Developments in Case Law

As described above, many Japanese companies adopt intra-company invention rules under which the employees are required to transfer the rights to the course-of-employment inventions to the company for pre-determined compensation amounts. In connection with same, there is a debate as to whether an employee, if unsatisfied with the compensation paid under such rules, can seek payment of additional consideration based on Paragraph 3 of Article 35 of the Patent Law, claiming that the compensation paid under the intra-company invention rules falls short of "due" compensation.

The Supreme Court, in its judgment of April 22, 2003 (Olympus case),⁴⁾ adjudicated on this issue for the first time. An employee of a company created an invention and transferred the right to apply for a patent on the invention to the company pursuant to the intra-company invention rules. The intra-company invention rules provided for consideration for such transfer to be paid as follows: 3,000 Yen at the time of filing an application with the Patent Office, 8,000 Yen at the time of registration of the patent, and 200,000 Yen at the time when the company received royalties from third party licensees. The total consideration actually received by the employee in accordance with the rules was 211,000 Yen. The employee sued the company, claiming that the payment made in accordance with the intra-company invention rules was far less than the due consideration required under the Patent Law. The employee alleged that the due consideration amounted to approximately 200 million Yen. The lower courts (Tokyo District Court and Tokyo High Court⁵⁾) found that due consideration was 2,500,000 Yen and ordered the company to pay the excess of 2,289,000 Yen. Both courts ruled that employees are entitled to claim due consideration beyond what is prescribed under the intra-company invention rules and that the amount of such compensation shall be

3) Takeda "Tokkyo Wa Darenomonoka (To Whom Patents Belong)" Diamond 2000, pages 142 - 164.

4) Hanrei Jiho No. 1822, page 39.

5) Tokyo District Court judgment of April 16, 1999 (Hanrei Jiho No. 1690, page 145). Tokyo High Court judgment of May 22, 2003 (Hanrei Jiho No. 1753, page 23).

ultimately determined/reviewed by the court. The Supreme Court upheld such ruling.⁶⁾

Following Olympus, the courts based their decisions on the above-mentioned April 22, 2003 Supreme Court ruling, finding in favor of the employee inventor in a couple of other cases concerning the consideration to be paid for the employee inventions. In each such case, employees sought payment of consideration for the transfer of course-of-employment inventions beyond what was provided in the intra-company invention rules. For example, the Tokyo High Court, in its judgment of January 29, 2004 (Hitachi Seisakusho case),⁷⁾ ordered the defendant company to pay approximately 128 million Yen in consideration.⁸⁾ This was, at that time, the highest award in this type of case. However, this amount was surpassed only a day later by the Tokyo District Court, which, in its judgment of January 30, 2004 (Nichia Kagaku case),⁹⁾ ordered a company to pay 20 billion Yen¹⁰⁾ to its former employee inventor.¹¹⁾ Both judgments were appealed.¹²⁾

Many Japanese companies have so far disposed of the course-of-employment inventions in

6) Although all three courts set aside the determination of consideration in the intra-company invention rules, the rationales used by each court are somewhat different. The District Court did not find the provision in the intra-company invention rules concerning the consideration binding upon the employee since the rules were unilaterally adopted and imposed by the company. The High Court emphasized the mandatory nature of the Patent Law provisions by ruling that the provisions prevent private arrangements made between the company and the employee to the extent that such arrangements conflict with the Patent Law provisions. The Supreme Court did not explicitly mention whether arrangements made under intra-company invention rules are binding or not, nor did the Court explicitly characterize the provisions as mandatory provisions. Instead, the Court seems to have based its opinion on the rationales adopted by both lower courts. For example, it stated that arrangements for consideration made under the intra-company invention rules do not necessarily fulfill the due consideration required under Paragraphs 3 and 4 of Article 35 of the Patent Law, even if such arrangements are made when the right to apply for the patent are transferred and when the contents and value of the rights are yet to be determined. In light of such a position, it is clear the Supreme Court considers the referenced Patent Law provisions to be mandatory provisions that cannot be excluded by the parties' private arrangement. At the same time, the Court called attention to the timing of the arrangement for consideration in the intra-company invention rules, indicating that the Court may have disposed of the case in a different way were the consideration arrangements made at a time when the contents and value of the patented invention had already materialized. The difference in the rationales may lead to the different conclusion if we change the facts. For example, under the District Court rationale, a court may uphold an arrangement made between a company and an employee if the employer and employee had reached an agreement on the consideration to be paid through discussions subsequent to the full or partial materialization of the contents and value of the patented invention ("ad-hoc agreement situation"). However, it is unlikely that the results would differ from the original decision, even in the ad-hoc agreement situation, if a court were to employ the High Court rationale. Having said the above, the reader should take note that the examples are merely hypothetical.

7) Hanrei Jihou No. 1848, page 25. Lower court ruling was Tokyo District Court judgment of November 29, 2002.

8) In this case, the court applied Article 35 of the Japanese Patent Law to the transfer of rights to apply for patents in foreign states.

9) Hanrei Jihou No. 1852, page 36.

10) In fact, the court held that 60 billion Yen was the proper amount of due consideration due. Since the plaintiff had made a partial claim up to 20 billion Yen, the award was 20 billion Yen. In the judgment, the employer's contribution to the creation of the invention was found to be 50%, in contrast to the Olympus case in which the employer's contribution was found 95%.

accordance with the intra-company invention rules, i.e., the employee inventions are transferred to the company for the consideration prescribed in the intra-company invention rules. The amount of consideration set forth in the rules is often very low and not related to the actual benefit to be received by the company as a result of the utilization of the invention (“non-merit-based compensation”).

However, the recent court decisions, with the shockingly-high compensation amounts awarded by the courts, have caused alarm bells to sound for those companies utilizing such practices. Aside from the compensation amounts themselves, companies are also troubled by the possibility that they would always be at risk of being sued by the employees claiming that the consideration paid in accordance with the intra-company invention rules is inadequate to qualify as the due consideration required by the law, as may be the case if we take the discussed court rulings at face value. The situation could also prove rather embarrassing for companies as such legal disputes will only arise after the invention is patented and the value of such invention is demonstrated through use.

IV Arguments

As pointed out above, the recent case law trends concerning employee inventions have aroused controversy. The industry has, not surprisingly, been very critical of these court rulings, stating that the courts are ignoring business realities while exposing companies to unreasonable and unforeseeable legal and financial risks.

While inventions are created daily by company employees, few will ever be the subject of lawsuits in which employee inventors demand due consideration, as there are several hurdles for the inventions to overcome prior to becoming commercially successful, cash-generating inventions. First, patent applications are filed for only some inventions, of which applications only a minority are approved. Second, products utilizing the patented invention must be developed so that they can be produced through mass-production. Although all inventions must be useful to qualify to be patented, it is important to note that such theoretical utility is quite different from the ability to actually use the

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- 11) The plaintiff, Professor Nakamura, disputed the transfer itself claiming that the invention was not made on duty, etc. The Tokyo District Court, in its interlocutory judgment of September 19, 2002 (Hanrei Jihou No. 1802, page 30), denied the plaintiff's allegation and ruled that the rights to the invention were duly transferred to the company.
 - 12) It has recently been reported that the Nichia Kagaku case was settled at the Tokyo High Court for 840 million Yen based on the judges' settlement recommendation. According to the judge's recommendation as reported in the press, the judges were of the opinion that the employer's contribution should be 95%, rather than the 50% as found in the Tokyo District Court.

patent on commercial basis, which utility is far more elusive. Third, such products utilizing the patented invention must be profit-making. This is the most difficult part. Only a tiny percentage of the inventions achieve final success. In other words, an overwhelming majority of the inventions are not patentable, useless or not commercially feasible.

It is impossible to determine at the time an invention is transferred (usually upon creation of the invention and before the patent application is even filed) what the due consideration for the invention should be in light of the economic benefits to be gained as a result of the invention because, at the time of transfer, there is no telling whether or not the invention will be able to be patented and, even if patented, whether the patent can be utilized in the company's products. Furthermore, the commercial success of products utilizing the patented inventions is another great uncertainty. Given such great uncertainties and the fact that only a few patented inventions will generate a profit, it is quite reasonable for the companies to adopt the current arrangements under which low, non-merit-based consideration is paid to employees for the employee inventions.

The courts have evaluated patented inventions only after the inventions have enjoyed commercial success, stating that such an evaluation standard is fair and that an employee should be entitled to share in the company's profit or revenue arising from a commercially successful invention. Such an approach simply ignores or significantly underestimates the uncertainties and risks mentioned above. Further, the commercial success of patented inventions is more often than not attributable to many people in addition to the inventors. Other employees and company management contribute to the profit through patent filing and prosecution, product development, marketing, sales and contract negotiation, and fund raising, among other things. Thus, critics of the courts' approach argue that it is not fair to heavily reward only the inventors while the other contributors to the profitability are left unrewarded.

On the other hand, employees, especially those who engage in research and development activities, generally welcome the recent court rulings. The courts in their rulings point out that the level of consideration paid by Japanese companies to the employee inventors has been poor in comparison to that paid by companies in foreign countries.¹³⁾ They argue that Japanese employees have been exploited by companies because the employees have been compelled under intra-company invention rules to give away the rights to the inventions. They further argue that the Japanese economy cannot be sustained if such a low reward system remains in place because it will cause

13) According to the research conducted by Hatsume Kyokai several years ago, the level of consideration was as follows (average): at the time of filing of patents — approximately 7,400 Yen; at the time of registration — approximately 16,000 Yen; at the time of utilization (or licensing) — approximately 97,000 Yen.

creative employee inventors to seek attractive employment opportunities abroad which will allow the employees to be handsomely compensated for the same research and development.

V Analysis

I do not disagree with the courts' interpretations that Paragraphs 3 and 4 of Article 35 of the Patent Law are mandatory provisions which cannot be excluded by private arrangement between the company and the employee. However, I find the rules laid out by the courts to be flawed and the methods employed by the courts in the determination of the due consideration and in the setting aside of the arrangements for consideration in the intra-company invention rules to be unsound. In my opinion, employment of such methods by the courts represents a major and unfortunate deviation from the legal framework under which businesses operate.

The crux of the problem of the recent court rulings is that by evaluating and ordering the payment of due consideration retrospectively, i.e., after the patented invention has been proven a commercial success, the court is virtually providing that the inventor employee is entitled to share in the profit the company has realized as a result of the utilization of the patented invention. This method is inimical to the principle of private autonomy: the parties are bound by what they have bargained for and, whatever profit or loss is brought about as a result of such bargain, no one, not even the court, may intervene retrospectively in order to make it fair and reasonable.¹⁴⁾

The reality of the transfer by an employee of the rights in his course-of-employment inventions is that, at the time of transfer, there are usually great uncertainties regarding the patentability, the success in the development of a product, as well as actual marketing and commercial success. Also, on a daily basis, companies handle the inventions of numerous employees. As companies lack the time and information to evaluate in depth the future value of such inventions, companies need to be able to handle these inventions collectively, rather than individually.¹⁵⁾ Given such uncertainties and risks, as well as the necessity of collective handling, low and non-merit based consideration arrangements made under many intra-company invention rules should be regarded as "reasonable", even if one invention later generates much more profit than initially expected. As critics of the court

14) In this respect, it is pertinent to point out that Paragraph 4 of Article 35 of the Patent Law says "the benefit to be enjoyed by the employer" and not "the benefit brought about to the employer". The letter of the provision dictates that the determination shall be made prospectively rather than retrospectively.

15) Given the uncertainties described above, to make individual assessment of the inventions transferred is not only costly and time consuming, but often illogical.

rulings argue, the courts ignore or grossly underestimate the risks and uncertainties - a reality of business - that are involved in the transfer of employee inventions.

One may argue that an employment contract is not an arms-length contract and therefore the private autonomy principle should not apply. That person would argue that it is naïve to consider the arrangements in the intra-company invention rules reasonable since such rules are in fact made and imposed unilaterally by the employer. However, the same argument could be made with regard to other exchanges of value that make up the employment relationship, including salary arrangements. We cannot accept a framework under which a court would require that due salary or reasonable salary be determined retrospectively based on the profits earned by a company as a result of the employee's contribution.¹⁶⁾

An argument can be raised that the question here is the transfer of property and the due consideration therefor, and, thus, the employee's property right is inalienable without the payment of due compensation. However, it is not obvious that the rights to course-of-employment inventions should vest in the employee rather than the company. While the invention may be a brain child of the employee and, in that sense, is created by him, that fact alone does not warrant sole ownership. Physical goods produced in the course of employment are not the property of the employee who manufactured them, even where his added value of labor far exceeds the value of the material. In terms of the investment made and risks borne by the company, it makes more economic sense that a company would be deemed to be the owner of the intellectual property generated in the course of employment¹⁷⁾ as that would allow ownership and risk to coincide. If intellectual property system is a legal system designed to give incentives to parties to create inventions, the argument for giving ownership to the party who bears the most risks, i.e., the company, is far more compelling.^{18) 19)}

16) Under the current laws, the government only provides for minimum wage.

17) Article 15 of Copyright Law, Law No.48 of 1970, as amended, adopts such a framework.

18) I am not developing an argument to the effect that, under the current law, a company rather than an employee shall be considered an owner of the employee's course-of-employment invention, nor do I argue for the revision of the current law to allow for company inventions (i.e., where the company is the inventor, rather than having the invention transferred from the natural person inventor). I merely would like to point out that the creation does not itself warrant ownership and, thus, one should not rely upon the transfer of property argument.

19) With regard to ownership, it is pertinent to note that the courts in numerous rulings have found that the employer's contribution to the invention was significant. For example, the Olympus case (supra.) the court found employer's contribution to be 95%. Even in the Nichia Kagaku case, Tokyo District Court found the employer's contribution was 50% (which percent seems to have been revised to 95% by the Tokyo High Court). I think that such a high contribution percentage in the evaluation of the due consideration amount is incongruous with the premise that the employee inventor is the proprietor of the invention.

The last point I should make is on the "incentive" argument. It is argued that in Japan there has been little incentive for employee inventors to continue inventing. The critics assert that if the Patent Law does not provide inventors with due consideration that reflects the business profit generated by the inventions, many creative employees will seek foreign employment; as such, public policy dictates that more consideration than currently given under the prevailing intra-company invention rules should be paid to the employee inventors. I do not intend to address the argument as to whether Japanese employees are given adequate incentives for their inventions. The real question here is whether it is proper for the courts to intervene and retrospectively determine what the proper incentives should be. I do not think it is. Evaluation of due consideration reflecting the economic value of the invention is difficult, but determination of a proper incentive is far more difficult. The courts are simply not equipped to make such a determination. As always, such matters should basically be entrusted to private autonomy and free competition in the labor market.²⁰⁾

If current case law trends continue, companies will never be able to be assured that adequate consideration has been paid to employees for the transfer of the employee inventions until after a lawsuit is filed and the court adjudicates. I do not think that this approach is a good one, especially because no guidelines are given for the determination of appropriate compensation.

As developed above, I disagree with the approach the recent courts have taken in setting aside the arrangement in the intra-company invention rules and in determining the due consideration amount. I do not mean to say, however, that the actual arrangement and consideration amount in each case was reasonable and due, and thus should have been sustained by the courts. It is a matter to be decided by taking into account all the relevant factors, including the process by which the consideration amount was determined. The degree of eventual commercial success of the subject invention is one such factor; it should not be the overriding factor, however.

VI New Rules

In 2004, the amendment to the Patent Law was enacted ("New Law").²¹⁾ It included an amendment to Article 35 of the Patent Law. The New Law maintains the current Paragraphs 1

20) Incidentally, the United States, a country believed to reward employee inventors well, does not have a similar legal framework. The consideration and reward are considered matters to be freely agreed between the company and the employee.

21) Law No. 79 of 2004. The New Law will be effective as of April 1, 2005. According to the supplemental provision of the New Law, the New Law shall apply to the inventions transferred on or after the effective date of the New Law and those inventions transferred before that date will be governed by the current law.

through 3 of Article 35, but now includes newly-inserted Paragraphs 4 and 5 instead of Paragraph 4 from the current law.

The new Paragraph 4 provides, in essence, that the consideration provided for under contracts or intra-company rules should not be unreasonable when considered in light of the following: the compensation criteria determined subsequent to consultation with the employees, the disclosure of such criteria, and a hearing of the employee's opinion in the process of determining the amount of actual consideration, among other things.

The new Paragraph 5 provides, in essence, that, if there is no pre-existing provision setting the amount of consideration or if the provision is considered unreasonable pursuant to the preceding Paragraph, the amount of consideration shall be determined by taking into account the following elements: (1) the benefit to be enjoyed by the employer as a result of the subject invention; (2) the employer's expenses and contribution in relation to the invention; and (3) other economic or non-economic rewards given to the employee; etc.

In short, the New Law, while maintaining the main framework of the current Article 35, emphasizes the process to be used to determine the amount of consideration. It is intended that the arrangements in contracts and intra-company invention rules concerning the amount of consideration to be paid will be upheld by the courts (and that the courts will not conduct a retrospective evaluation of such amounts) so long as the processes for making such arrangements are proper.

The New Law was a response to criticism from the industry that the current law as interpreted and applied by the courts in recent rulings unduly exposes companies to the risk of being sued by employees. Under the New Law, the occasions on which the courts would determine the amount of due consideration retrospectively should be reduced.

However, problems remain. One can question whether it is possible for a company to engage in a meaningful consultation with its employee when attempting to set forth the criteria for the determination of the consideration amount. Furthermore, there is already criticism that it is very difficult for the companies to fully comply with the process requirements exemplified in New Paragraph 4.²²⁾ Another problem is that, even if the company fully complies with the process requirements under New Paragraph 4, uncertainty remains as to whether a court will uphold the

22) In September 2004, the Patent Office issued the Exemplary Guidelines for the new Paragraph 4 of Article 35 of the Patent Law. The Exemplary Guidelines indicate that the consultation must be conducted with all the employees or, in the alternative, with representatives of all the employees.

consideration amount determined between the company and the employee through an adequate determination process if the invention has generated exceptional revenue for the company and the employee demonstrates that the amount of consideration he received is far short of the due consideration amount which would be set under New Paragraph 5.²³⁾

The application of the standards laid out under the New Law remains to be seen.

23) The Exemplary Guidelines are not clear on this point.