

Effects of Civil Code amendment on IP licence agreements

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Introduction

The Act Partially Revising the Civil Code (Act 44 of 2017) was enacted on 26 May 2017. The act, which significantly amended the provisions of the Civil Code originally promulgated in 1896 and enforced in 1898 (Act 89 of 1896), was the first significant amendment to the Civil Code in approximately 120 years. The amended Civil Code came into force on 1 April 2020.

As the Civil Code is the basic private law in Japan, the amended version will have a significant impact on the legal aspects of people's lives and their business relationships. Moreover, many of its provisions will affect IP licence agreements. Owing to dissenting opinions, the Civil Code does not stipulate such agreements as a typical contract type; nevertheless, this article addresses the relevant provisions.

In principle, the amended Civil Code applies only to contracts governed by Japanese law and executed on or after 1 April 2020. However, where a contract executed before 1 April 2020 is updated on or after 1 April 2020, the amended Civil Code will apply.

In addition, the amended Civil Code Pre-formulated Terms and Conditions applies to pre-formulated terms and conditions prepared before 1 April 2020, unless the contracting party, which has no right to cancel the contract, manifested its intention of opposition in writing before 1 April 2020.

Object of contract

IP licence agreements must provide details of the contract's object or background. The amended Civil Code clearly stipulates that it respects the object of a contract provided by the contracting parties. For example, with respect to the impossibility of performance, Article 412-2(1) of the amended Civil Code stipulates that an obligee cannot demand the performance of a debtor's obligation if the performance of such obligation is impossible in light of the causes of the obligation, such as contracts and the social norms regarding trade.

In addition, with respect to damages due to a default in obligations, Article 415(1) of the amended Civil Code stipulates that a party cannot demand damages if the default in the obligation is caused by reasons not attributable to the obligor, in light of the cause of the obligation (eg, contracts and the social norms regarding trade).

Further, with respect to the cancellation of a contract by demand, Article 541 of the amended Civil Code stipulates that a party cannot cancel a contract if the default in obligation is insignificant in light of contracts and the social norms regarding trade. In addition, under Item 3 of Article 542(1), only if the object of a contract is unachievable may said contract be cancelled without demand.

As the object of a contract or the intent of the contracting parties might affect the damages due to a default of obligations and cancellation of the contract under the amended Civil Code (as described above), IP licence agreements should clearly provide details of the contract's object or background.

Extinctive prescription

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In conjunction with the amendment to the Civil Code, Article 522 of the Commercial Code (Act 48 of 1899), which stipulates extinctive prescription for commercial affairs, has been abolished. Thus, the provisions relating to extinctive prescriptions under the amended Civil Code would be applied to both non-commercial and commercial affairs.

Under Article 166(1) of the amended Civil Code, obligations such as royalty payments will be extinguished if a creditor fails to exercise its credit which corresponds to the obligation within five years from the date on which the creditor knew that it could exercise its credit or 10 years from the date on which the creditor could objectively exercise the credit, whichever is earlier.

With respect to IP licence agreements, licensors should know when they can exercise their right to seek royalty payments thereunder; such agreements normally set out the amount and date of said payments. Therefore, under normal circumstances, the obligation to pay royalties under an IP licence agreement expires five years from the payment date set out in the IP licence agreement, and there is no difference as to the term of the extinctive prescription under the amended Civil Code.

In light of the above, IP licence agreements should clearly provide the deadline for payment to avoid unnecessary disputes over the term of the extinctive prescription. The statutory term of extinctive prescription may be shortened by agreement between the contracting parties. However, the statutory term of the extinctive prescription cannot be extended by agreement, because said agreement would be contrary to Article 146 of the Civil Code, which stipulates that the benefits of the prescription cannot be waived in advance.

Statutory interest rate

Statutory interest rates affect the amount of late payment charges for a royalty under an IP licence agreement. As Article 514 of the Commercial Code, which stipulates the statutory interest rate for commercial affairs (annual rate of 6%) was abolished, the provision of the amended Civil Code relating to the statutory interest rate applies to both non-commercial and commercial affairs.

Under Article 404(1) of the amended Civil Code, the statutory annual interest rate is 3%, and this rate will be reviewed every three years considering the market interest rates. In this regard, the statutory interest rate at the beginning of a delay in performance will be applied in case of said delay in performance. However, as Article 404 of the amended Civil Code is not a mandatory provision and can be excluded by agreement between the contracting parties, if a party wishes to apply a different interest rate, it must provide said rate in the contract.

Non-conformity in contract subject matter

Before its amendment, Article 570 of the Civil Code set out sellers' warranties against so-called 'latent defects' in contract subject matter. However, instead of latent defects, the amended Civil Code refers to the concept of 'non-conformity'. Thus, if a non-conformity is identified in a contract's subject matter, the obligee can cancel the contract, demand damages, demand the completion of the performance or ask for a price deduction (Articles 561 to 566 of the amended Civil Code).

It remains unclear whether these articles apply to IP licence agreements. Such agreements should therefore include clauses on representations and warranties as they relate to (for example) non-infringement and validity.

Contract cancellation and reasons attributable to obligor

The amended Civil Code also affects the cancellation of IP licence agreements. Before the amendment, an obligee could not cancel their contract with an obligor if there was no reason attributable to said obligor. Under the amended Civil Code, an obligee can cancel their contract with an obligor if there is a default in the obligor's obligation even if there is no reason attributable thereto (Articles 541 and 542 of the amended Civil Code). However, an obligee cannot cancel their contract with an obligor if the default in the obligor's obligation is caused by a reason attributable to the obligee (Article 543 of the amended Civil Code).

In addition to the above, under the amended Civil Code, an obligee cannot cancel their contract with an obligor if the default in the obligor's obligation is insignificant in light of contracts and the social norms regarding trade (proviso of Article 541 of the amended Civil Code).

However, as these provisions are not mandatory and can be excluded by agreement between the contracting parties, it is advisable to provide clauses that are different from these provisions which would apply separately therefrom (if necessary).

Pre-formulated terms and conditions

Certain restrictions on 'pre-formulated terms and conditions' (*teikei yakkan* in Japanese) have been

newly adopted in the amended Civil Code. In an IP context, this is likely to affect (for example) software licence agreements. The terms of use of online services may also fall under pre-formulated terms and conditions.

The amended Civil Code Pre-formulated Terms and Conditions cover all of the provisions unilaterally prepared by a specific person for the purpose of providing the contract's contents in a 'pre-formulated transaction' that is conducted between a specific person and an unspecified number of persons, if it is reasonable for all concerned parties that all or part of the contract's contents be uniform (Article 548-2(1) of the amended Civil Code).

Under the amended Civil Code, parties to a pre-formulated transaction are deemed to have agreed to the individual provisions of the pre-formulated terms and conditions if:

- they have agreed to make the pre-formulated terms and conditions the contents of their contract; or
- the party that prepared the pre-formulated terms and conditions indicates to the other party in advance that the pre-formulated terms and conditions will be the contents of the contract (Items 1 and 2 of Article 548-2(1) of the amended Civil Code).

However, clauses that restrict the rights or increase the duties of a counterparty and unilaterally impair the interests thereof, contrary to the fundamental principle of the amended Civil Code and in light of the transaction method, circumstances of the transaction and social norms regarding trade, will not be deemed to have been agreed upon (Article 548-2(2) of the amended Civil Code)

Under the amended Civil Code, the party which prepares the pre-formulated terms and conditions must meet either of the following requirements in order to amend said terms and conditions:

- the amendment conforms to the general interests of the other party; or
- the amendment is not contrary to the purpose for which the original contract was made, and is reasonable in light of the necessity of the amendment, appropriateness of the content after amendment, the existence of provisions that the pre-formulated terms and conditions may be amended under the Civil Code and other circumstances relating to the amendment (Items 1 and 2 of Article 548-4(1) of the amended Civil Code).

In addition, the party which prepares the pre-formulated terms and conditions must provide for the timing of an amendment taking effect and provide notice of the timing of said amendment taking effect by an appropriate method (eg, via a notice on its website) (Article 548-4(2) of the amended Civil Code).

Most significantly, under the amended Civil Code, the provisions relating to pre-formulated terms and conditions also apply to foreign parties that prepare pre-formulated terms and conditions where the counterparty is an individual with habitual residence in Japan, even if the governing law of the terms and conditions is not Japanese law (Article 11(1) of the Act on General Rules for Application of Laws (Act 78 of 2006)).

All parties which intend to use pre-formulated terms and conditions in their business contracts (eg, software licence agreements) in Japan should prepare clauses in compliance with the above requirements.

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