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SPRING CLEANING – EMPLOYEE INVENTION RIGHTS ARE SWEPT AWAY IN JAPAN

Thanks to recent amendments in Japanese patent laws, Japanese companies can more readily retain exclusive ownership over inventions created on the job by their employees. The patent law amendments make it possible for employers to abolish the rights to inventions created on the job by their employees, and government guidelines that will come into effect shortly, aim to reduce ambiguities concerning payments that should be made to employee-inventors when sweeping away their patent ownership rights. The foregoing changes should provide a windfall to (i) companies operating in Japan, because critical intellectual property value can be more easily captured by the company, and (ii) acquirers and sellers of Japanese companies, because they can more easily determine the ownership rights of target companies over inventions created on the job.

This edition of the *Corporate Counselor* first discusses the treatment of employee inventions prior to the recent amendments to Japanese patent laws, then discusses the significant benefits to employers afforded by the recent patent law changes, and concludes with how an employer can take advantage of these changes.

Prior sole treatment of employee inventions. Under Japanese patent laws in effect through March 31, 2016 (which treatment has not been abandoned under the new amendments to Japanese patent laws but made optional, as explained below), when an employee creates an invention in the course of performing his/her professional duties at work, the right to obtain a patent for the invention rests with the employee-inventor. However, the employer is automatically granted a royalty-free, non-exclusive license to use such invention because the employer contributed to the origination of the invention, such as by employing the employee-inventor, providing research facilities to the employee-inventor, and bearing research and development costs. As an alternative to the right to receive a royalty-free, non-exclusive license, the employer is allowed to reserve ownership rights in the patent or patent right (or obtain an exclusive license right) over the invention if these additional rights are provided in the employer's work rules and/or in an employment-related agreement with the employee-inventor. When an employer succeeds to the ownership rights of its employee's invention (or obtains an exclusive license right), then the employee has the right to receive "***reasonable value***" in the form of cash from his/her employer in connection with such invention ownership conversion. If the employee has not received "reasonable value" for his/her converted invention ownership rights, then the employee can demand the difference between a court determined reasonable value amount for his/her converted invention ownership rights and the amount of money actually received by the employee from his/her employer for such converted invention ownership rights.

Significant amounts have been awarded to employees who have disputed the reasonableness of the compensation paid to them in connection with the employer succeeding to the employee's invention ownership rights. For example, in 2004 the Tokyo District Court awarded JPY20 billion as the "reasonable value" that should be paid to an employee-inventor at Nichia Corporation in exchange for his transfer to the company of his invention rights in blue-light-emitting diodes, and around the same time Japanese courts awarded employee-inventors at Hitachi and Ajinomoto approximately JPY170 million and JPY190 million, respectively, as the "reasonable value" for invention ownership transfers. Subsequent to these court decisions, Japanese patent laws were amended on June 4, 2004 to show greater deference to an employer's work rules concerning compensation for employee inventions so long as (i) the employee is afforded "due process" when discussing the compensation terms for inventions (with "due process" not defined), (ii) the employer's invention compensation rules are readily available to employees, and (iii) the employer listens in good faith to the views of the employee-inventor when addressing invention compensation grievances.

Despite the 2004 amendments to Japanese patent laws, many Japanese companies reportedly were concerned that employee-inventor compensation rules would not be honored by Japanese courts, thereby making it difficult for employers to establish budgets and manage their financial returns. Under Japanese judicial practice, the "reasonable value" of an employee derived invention is often calculated by multiplying the employer's profit from the invention by the degree of the employee's contribution. The latter (the degree of the employee's contribution) is basically a matter of fact finding; however, the former (the amount of the employer's profit) involves more complicated legal issues that have greater ambiguity (and such unpredictability could improve the negotiating position of the employee-inventor since large sums potentially could be awarded).

Reacting to these and other concerns, on July 10, 2015 Japan's House of Councilors passed sweeping changes that should benefit employers who desire to promptly solidify their ownership interests in inventions created on the job and to fix with greater certainty the amount of payments that they need to make to employee-inventors.

New treatment of employee inventions. From April 1, 2016, an employer can elect to continue the employee invention ownership scheme pursuant to the rules existing immediately prior to April 1, 2016 (which scheme is discussed above and will remain available), or an employer can elect to follow a new scheme under revised Japanese patent laws (the "**New Invention Ownership Rules**") pursuant to which the employer will be granted an exclusive ownership interest in the first

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instance over all inventions created on the job by its employees so long as (i) notice about such ownership scheme is disclosed in advance to the applicable employees (typically through an employer's work rules) and (ii) the employer's work rules contain an adequate formulation for the amount of "***reasonable profit***" that an employee-inventor should receive for his/her on the job invention.

The New Invention Ownership Rules present a major pivot from the immediately prior scheme because under the New Invention Ownership Rules the employer (and not the employee) is considered in the first instance as the owner of an invention created on the job. Furthermore, the calculus for "reasonable profit" can lead to significant benefits to an employer due to the perceived greater certainty surrounding the calculation of "reasonable profit" versus "reasonable value."

An employer can establish upfront a definitive and binding value for "reasonable profit" so long as the employer follows guidelines issued by Japan's Ministry of Economy, Trade & Industry (the "METI Guidelines"), a draft of which was published on January 8, 2016. The draft METI Guidelines are expected to become effective by the end of April 2016. Even though the draft and final METI Guidelines should be substantially the same, it would be prudent for an employer wishing to adopt the New Invention Ownership Rules to wait until the final version of the METI Guidelines is officially declared effective.

Summarizing the "reasonable profit" guidance under the METI Guidelines is beyond the scope of this newsletter, but the following are key considerations along with practice tips (*in italics*):

- A "reasonable profit" formulation should be finalized once the employer has held negotiations with all of the company's employees (which all-employee negotiations can be conducted through an intranet chatroom or through other suitable electronic means) or with the company's employee representative. The negotiations should be conducted in good faith by the employer, which good faith can be demonstrated if the employer actively listens to the concerns raised by the employee's representative/employees, and the negotiations are sufficiently long to enable substantive involvement by the employee's representative/employees.

  Meaningful negotiations lasting two to four weeks should be sufficient for a mid-size company with employees based in a few locations.

- Failure to reach agreement with the employee's representative/employees concerning "reasonable profit" will <u>not</u> negate the validity of the "reasonable profit" formulation set by the employer. The formulation for "reasonable profit" established by the employer will remain binding and if the employees dislike this result, then the onus will be on the employees to initiate a lawsuit alleging that the employer did not engage in good faith negotiations.

  To help defend itself against bad faith negotiation challenges, an employer should maintain detailed and well documented meeting minutes.

- A "reasonable profit" formulation does not need to be limited to cash compensation, as in-kind consideration also can be included (such as the provision of overseas training, extra paid vacation time, or the issuance of stock options).

  The benefits of in-kind consideration may not enjoy universal appeal from all employees, so an employer should carefully consider the type of in-kind consideration offered and its overall weight when calculating the total value of "reasonable profit."

- A "reasonable profit" formulation does not need to be tied to the monetary benefits received by the employer from the employee's invention. Instead, a fixed amount ordinarily can be established or a variable formula can be adopted that includes a cap on the maximum amount that can be paid to an employee-inventor.

  It is conceivable that employees will object to a formulation where major and minor innovations receive the same fixed payment amount, so payments may need to be tiered according to criteria determined by an ad hoc innovation committee.

- "Reasonable profit" payments for inventions can cease once the employee-inventor is no longer employed by the employer.

  Given the difficulties under Japanese labor laws to terminate an employee, the foregoing payment cessation right should not lead to manipulative employment terminations by unscrupulous employers, but could have a significant impact on employees who voluntarily decide to seek other employment opportunities or reach the age of retirement. Also, it is conceivable that employees will object to a scenario where an employee-inventor ceases to receive payments after a short period of time regardless of the reason for his/her departure, so a minimum payment stream may need to be considered.

- A "reasonable profit" formulation will apply only to those persons employed by the employer as of the date the formulation was adopted. Persons employed by the employer subsequent to such adoption date must be promptly informed about the employer's "reasonable profit" calculus, and given an opportunity to ask questions

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and receive answers.

> *The information exchange between the employer and the new employees would not be a negotiation, but would more closely resemble an information sharing session occurring at a typical introductory session for new employees.*

While an employer has the flexibility to apply the New Invention Ownership Rules to all or a portion of its employees, to all or a portion of its business segments, or to some other easily identifiable matrix, an employer cannot apply the New Invention Ownership Rules retroactively to periods prior to April 1, 2016. Similarly, an employer is not confined to a "reasonable profit" formulation after its adoption, as an employer can tweak such calculation from time to time so long as it follows steps similar to those that are necessary to establish a "reasonable profit" formulation and the modified formula does not apply retroactively.

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Companies in Japan that desire to adopt the New Invention Ownership Rules will need to amend their work rules to incorporate "reasonable profit" provisions. Given the recent effectiveness of the New Invention Ownership Rules and the METI Guidelines (forthcoming), expert counsel should be contacted at an early stage to assist with the drafting of such amendments and the implementation process.

Considering the time and expense to amend employer work rules, for efficiency purposes it could be prudent for an employer to take a fresh look at all of its work rules and incorporate Japanese legal changes and best practices that have been adopted since the last time the employer's work rules were revised. In connection with such work rule overhaul, an employer could consider whether it is necessary to more closely align its work rules and employment agreements in order to avoid an unexpected trap of having its negotiated employment agreements deemed unenforceable under Japanese labor laws (as discussed here).

While the New Invention Ownership Rules provide a fertile ground for Japanese companies to capture value, if employers adopt and cramdown frugal "reasonable profit" formulations, then employees may have less of an incentive to create inventions on the job and there could be an exodus of innovative talent from Japan or to local competitors who offer comparatively more favorable "reasonable profit" formulations.