

Inventing on the job; who holds the rights?

June 06 2016 | Contributed by [Nishimura & Asahi](#)

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Introduction

Recent patent law amendments have made it easier for employers to retain exclusive rights to employee inventions. The amendments enable employers to abolish employees' patent rights to inventions created during the course of their employment. In addition, new government guidelines aim to reduce ambiguities concerning payments that should be made to employee inventors when abolishing these rights.

These changes should benefit both:

- companies operating in Japan (as it will be easier for them to capture critical IP value); and
- acquirers and sellers of Japanese companies (as it will be easier for them to determine a target company's rights to its employees' inventions).

This update discusses the prior treatment of employee inventions and the significant benefits afforded to employers by the recent amendments.

Prior treatment of employee inventions

Before April 1 2016, an employee who created an invention in the course of performing his or her professional duties had the right to obtain a patent for the invention. However, the employer was automatically granted a royalty-free non-exclusive licence to use the invention because it had contributed to its creation by:

- employing the employee inventor;
- providing research facilities; and
- bearing the research and development costs.

As an alternative to the right to receive a royalty-free non-exclusive licence, the employer could reserve succession to the right to obtain the patent or patent right (or obtain an exclusive licence) if these additional rights were provided in the employer's work rules or in an employment-related agreement with the employee inventor. If the employer succeeded to the right from the employee inventor (or obtained an exclusive licence), the employee had the right to receive 'reasonable value' in the form of a monetary payment from the employer. If the employee did not receive 'reasonable value' for the succession of the right (or exclusive licence), the employee could demand the difference between a court-determined reasonable value amount and the amount of money that he or she had actually received.

Significant amounts have been awarded to employees who have disputed the compensation paid to them by their employers for the succession of their patent rights. For example, in 2004 the Tokyo District Court awarded ¥20 billion to an employee inventor at Nichia Corporation as reasonable

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value for his transfer to the company of his rights to blue-light-emitting diodes (for further details please see "[Paying reasonable value to employee inventors](#)"). Around the same time, courts awarded employee inventors at Hitachi and Ajinomoto approximately ¥170 million and ¥190 million (respectively) as reasonable value for their patent rights. Subsequent to these decisions, the patent law was amended on May 1 2005 to give greater deference to an employer's work rules concerning compensation for employee inventions when:

- the employee was afforded due process when discussing the compensation terms for inventions ('due process' was not defined);
- the employer's invention compensation rules were readily available to employees; and
- the employer listened in good faith to the employee inventor's views when addressing invention compensation grievances.

Despite the 2005 amendments, many companies were reportedly concerned that employee inventor compensation rules would not be honoured by the courts, thereby making it difficult for employers to establish budgets and manage their financial returns. Under judicial practice, the reasonable value of an employee-derived invention is usually calculated by multiplying the employer's profit from the invention by the degree of the employee's contribution. While the latter is basically a matter of fact finding, the former involves more complicated legal issues that have greater ambiguity. This ambiguity could improve the employee inventor's negotiating position as large sums could be awarded.

Reacting to these and other concerns, on July 3 2015 the Japan House of Councillors passed sweeping changes that should benefit employers wanting to solidify their interests in employee inventions and fix the amounts that they must pay to employee inventors with greater certainty.

New treatment of employee inventions

From April 1 2016 an employer can elect to continue the employee invention rights holder scheme pursuant to the rules existing immediately before April 1 2016 or follow a new scheme under the revised patent law. Pursuant to the revised law, the employer will be granted an exclusive rights holder interest in the first instance to all employee inventions if notice about the rights holder scheme is disclosed in advance to the applicable employees (typically through an employer's work rules). In such case, employees have the right to receive reasonable profit.

The new rights holder rules signify a major shift from the previous scheme, as the employer (and not the employee) will be considered in the first instance to be the rights holder of an employee invention. Further, the reasonable profit formulation can lead to significant benefits to an employer due to the perceived greater certainty surrounding the formulation of 'reasonable profit' versus 'reasonable value'.

An employer can establish upfront a definitive and binding value for reasonable profit if it follows guidelines issued by the Ministry of Economy, Trade and Industry.

Ministry of Economy, Trade and Industry guidelines

The following key considerations should be taken into account by employers.

Negotiation

A reasonable profit formulation should be finalised once the employer has held negotiations with all of its employees (all-employee negotiations can be conducted through intranet chatrooms 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 can be demonstrated if the employer actively listens to the concerns raised and the negotiations are sufficiently long enough to enable substantive involvement by the employees or their representative.

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

Failure to reach agreement

Failure to reach agreement with the employees or their representative concerning reasonable profit will not negate the validity of the reasonable profit formulation set by the employer, which will remain binding. If the employees dislike this result, the onus will be on them to initiate a lawsuit alleging that the employer did not engage in good-faith negotiations.

To help defend themselves against bad-faith negotiation challenges, employers should maintain detailed and well-documented meeting minutes.

Type of compensation

A reasonable profit payment is not limited to cash compensation; in-kind consideration can also be included (eg, the provision of overseas training or extra paid holiday time or the issuance of stock options).

The benefits of in-kind consideration may not be favourable to all employees. Thus, employers should carefully consider the type of in-kind consideration offered and its overall weight when calculating the total value of reasonable profit.

Cap on maximum amount

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

Employees may object to a formulation where major and minor innovations receive the same fixed payment amount. Thus, payments may need to be tiered according to criteria determined by an *ad hoc* innovation committee.

Cessation

Reasonable profit payments for inventions can be discontinued once the inventor's employment ceases.

Given the strict labour laws, the foregoing payment cessation right should not lead to manipulative employment terminations by unscrupulous employers. However, it could have a significant impact on employees who voluntarily decide to seek other employment opportunities or reach retirement age. Employees may also object to a scenario where an employee inventor will cease to receive payments after a short time, regardless of the reason for his or her departure. A minimum payment stream may therefore need to be considered.

Scope

A reasonable profit formulation will apply only to persons employed by the employer as of the date on which it was adopted. Persons subsequently employed by the employer must be promptly informed about its reasonable profit formulation and given an opportunity to have any questions answered.

This type of information exchange does not constitute a negotiation; it more closely resembles information sharing sessions that occur at typical introductory sessions for new employees.

An employer can apply the new rights holder rules to all or some of its employees or divisions. However, it cannot apply them retroactively to inventions created before April 1 2016. Similarly, an employer is not tied to a reasonable profit formulation after its adoption and can amend it if it follows steps similar to those that were necessary to establish it. The modified formulation cannot be applied retroactively.

Comment

Companies wanting to adopt the new rights holder rules in regards to employee inventions must amend their work rules to incorporate reasonable profit provisions.

Considering the time and expense involved in amending employer work rules, it would be prudent for employers to take a fresh look at all of their work rules and incorporate legal changes and best practices that have been adopted since they were last revised.

While the new rights holder rules provide fertile ground for companies to capture value, if employers adopt frugal reasonable profit formulations, employees may have less of an incentive to create inventions in the course of their employment. This could lead to an exodus of innovative talent to other countries or local competitors that offer more favourable reasonable profit formulations.

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