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THE PITFALLS OF FAILING TO "REASONABLY" COMPENSATE EMPLOYEE INVENTORS IN JAPAN.

**EMPLOYERS  
BEWARE**

The United States is generally considered a more litigious country than Japan, where customs traditionally favor a less confrontational approach to dispute resolution. But there is one exception—employee invention lawsuits. A recent series of lawsuits filed by aggrieved employee inventors against their employer companies, demanding “reasonable remuneration” for the employees’ inventions, has brought attention to this unique area of Japanese patent law—and raised concern in the business community. Japanese companies were shocked to find themselves facing the possibility of

paying seven-figure sums in compensation for employee inventions, having expected that the compensation provided in the ordinary employment contract or internal employment regulations would be accepted by courts as reasonable. This stunning development in Japanese courts is based on Japan’s unique employee invention system under Article 35 of the Japan Patent Law, and foreign companies doing business in Japan, especially those with R&D facilities there, should be familiar with the provisions of Article 35 and the case law applying it.

## ORIGIN OF THE FUSS—ARTICLE 35 AND THE *OLYMPUS* CASE

**Article 35 of the Japan Patent Law.** Japan has a unique employee invention system under Article 35 of the Patent Law. That article provides a number of important rights for employee inventors.

First, if an employee makes an invention that, by the nature of the invention, falls within the scope of the business of his employer and was achieved by acts within the employee's duties for the employer (an "employee invention"), the right to obtain a patent on the invention *originally belongs to the employee* (Article 35, Paragraph 1). This is different from the practice in countries such as the United Kingdom and France, where the right to obtain patents for employee inventions originally belongs to the employer.

An employer, however, may enter into a contract with an employee or establish internal employment regulations providing *in advance* that the right to obtain a patent for any employee invention shall be assigned to the employer, or that an exclusive license for any employee invention shall be granted to the employer (established construction deriving from Article 35, Paragraph 2).

If an employer acquires the right to obtain patents for employee inventions from an employee, the employer must pay a reasonable remuneration to the employee (Article 35, Paragraph 3).

Prior to the *Olympus* case, Japanese companies believed that if they unilaterally established internal employee invention rules that set an amount of remuneration in exchange for the assignment of inventions from employees, such amount would be duly respected by Japanese courts as valid and binding. The amount of remuneration provided in those employment regulations was usually not high, frequently around just a few hundred dollars. The *Olympus* case changed the landscape.

**The *Olympus* Case.** The 2003 Japanese Supreme Court decision in *Olympus Optical v. Tanaka* (1822 *Hanrei Jiho* 39) gave employee inventors clear grounds to assert claims for deficient remuneration for their inventions even when payment had been provided for in internal employment regulations. In that case, Olympus had employment regulations providing that it had the right to obtain patents for employees' inventions and that employee inventors would

be entitled to remuneration based on income from the patents. Pursuant to those regulations, Olympus acquired a patent on employee Tanaka's invention. Olympus then licensed the patent as part of a patent portfolio to many licensees in Japan, resulting in a royalty income of many billions of yen. The employee inventor, Tanaka, received remuneration in the amount of 3,000 yen for the patent application, 8,000 yen for the patent grant, and 200,000 yen as a later bonus payment—a total of slightly more than \$1,800.

The Supreme Court affirmed the trial court's decision that the reasonable amount of remuneration under Article 35 should be 2.5 million yen (approximately \$22,000) and ordered Olympus to pay the balance. The Court held that even if there is an employment regulation concerning the remuneration to be paid to employee inventors, and the employee receives payment pursuant to such internal regulations, the employee is entitled to demand a reasonable amount that ought to be paid for the invention based on its actual value.

The *Olympus* case thus established that an employee inventor has a right to claim additional remuneration for an invention if the amount actually received under the employer's regulations is unreasonable—less than what ought to be paid. As a result, many lawsuits followed, including actions against Hitachi, Nichia, and Ajinomoto. Awards in several cases were quite high—for example, the employee inventor in the *Nichia* case successfully obtained an award of around 840 million yen (approximately \$7.3 million). The *Olympus* case, however, left many issues unresolved, particularly as to how reasonable remuneration should be determined under Article 35. One such unresolved issue was whether Article 35 applies to foreign counterpart patents deriving from a Japanese patent. The 2006 Supreme Court decision in *Hitachi vs. Yonezawa* (1951 *Hanrei Jiho* 35) finally resolved this issue.

## SHOULD FOREIGN COUNTERPART PATENTS ALSO BE CONSIDERED UNDER ARTICLE 35?

**Facts.** The plaintiff in *Hitachi* was a former employee who had made many inventions during the course of his employment related to the recording of digital data on optical disks. Hitachi had entered into an agreement with the plaintiff under which the right to obtain patents concerning these inventions was assigned to Hitachi, and Hitachi obtained patent rights in Japan and abroad. In consideration of this

assignment, Hitachi paid 2,380,100 yen (more than \$21,000) to the employee inventor pursuant to Hitachi's invention remuneration rules. Hitachi profited significantly from its patent portfolio licensing agreements that included the patents for the plaintiff's inventions.

**Lower-Court Decisions.** The Tokyo District Court and the Tokyo High Court took different views as to whether foreign patents should be taken into account in calculating reasonable remuneration under Article 35, Paragraphs 3 and 4. The Tokyo District Court ordered Hitachi to pay approximately 35 million yen (approximately \$305,000) as remuneration under Article 35, Paragraph 3. In determining that amount, the Tokyo District Court did *not* include remuneration for foreign patents based on the Japanese priority patent applications for the subject inventions. The District Court stated that because of the doctrine of territoriality, Article 35 of the Japan Patent Law should apply only to Japanese patent rights, and not to foreign counterpart patents.

The Tokyo High Court reversed the holding of the District Court, finding that Article 35 of the Patent Law should apply not only to Japanese patents, but also to counterparts in foreign countries. The Tokyo High Court then determined that the reasonable amount should be 165,383,816 yen (approximately \$1.4 million), considering the value of global package cross-licensing agreements (even if Hitachi did not receive royalty payments under those cross-licensing agreements).

**The Supreme Court Decision.** The Supreme Court upheld the decision of the Tokyo High Court and specifically addressed whether an employee could claim reasonable remuneration for assignment of the right to obtain foreign patents under Article 35, Paragraph 3.

First, the Supreme Court held that Japanese law should govern the right to demand compensation for assignment of rights to obtain patents in foreign countries, stating that the governing law of this issue should be decided primarily by the intent of the parties according to Article 7, Paragraph 1, of the Law Concerning Conflict of Laws (*Horei*). The Court found that the parties had implicitly agreed that the applicable law concerning the assignment of the right to obtain patents (including foreign patents) should be Japanese law.

Second, the Supreme Court held that Article 35, Paragraph 3, is not directly applicable to foreign patents because the

Japan Patent Law does not directly regulate matters concerning foreign patents. The Court found that the phrase "the right to obtain a patent" in Article 35 did not literally include the right to obtain foreign patents. However, the Court held that Paragraph 3 should be applied by analogy to foreign patents for several reasons:

- The Court found no reason to differentiate between Japanese patents and foreign patents in terms of negotiating power between an employer and employee. The Court stated that "the objective of Article 35, Paragraphs 3 and 4, is to encourage inventions and thereby to contribute to the development of industry, which is the objective of the Patent Law, through protecting an employee who created an employee's invention . . . taking it into consideration that it is difficult for an employee to make a deal with his/her employer on equal terms because of the fact that the employee is employed by the employer and the employee invention is made based on such employment relationship. As to this objective of Article 35, Paragraphs 3 and 4, the difficulty for an employee to deal with his/her employer on equal terms is the same whether said right is to obtain Japanese patents or foreign patents."
- The Court emphasized that foreign patents and Japanese patents derive from the same invention. The Court stated, "While the right to obtain a patent exists respectively in each country, the invention on which the right to obtain a patent is based is the result of the same technological creative activity."
- The Court found that the parties' ordinary intent was to address all rights and obligations between the employee and the employer arising from the subject invention, whether domestic or foreign.

The *Hitachi* decision thus significantly increased the stakes in employee inventor lawsuits, since it made the global portfolio available in considering the value of the employee invention.

#### **THE 2004 AMENDMENTS TO ARTICLE 35— HAS THE PROBLEM BEEN RESOLVED?**

The Supreme Court's decisions in *Olympus* and *Hitachi* made it clear that a company's internal employee invention rules cannot by themselves establish what is "reasonable remuneration" for an employee's invention. If the compensation to the employee is not "reasonable remuneration" under

Article 35, Paragraph 3, a disgruntled employee is entitled to payment of the deficiency. But what's "reasonable"? Prior to 2004, Article 35, Paragraph 4, provided that in determining reasonableness of payment, the amount of the employer's benefit from the invention and the extent of the employer's contribution to the invention must be taken into consideration, but this language provided little clarity to companies seeking certainty and predictability. With a view to resolving this uncertainty and avoiding unnecessary legal disputes between employee and employer, an amendment to Article 35 was enacted on May 28, 2004, and came into effect on April 1, 2005.

The amendment changed Article 35 in two respects:

First, Paragraph 4 was revised to specify that remuneration by an employer pursuant to a contract, employment regulation, or other stipulation shall not be considered unreasonable in circumstances where there is consultation between the employer and the employees to set standards for remuneration, there is disclosure of the standards for remuneration, and the opinions of employees concerning the amount of remuneration are heard by the employer.

Further, the new Paragraph 5 provides that (i) where no provision setting forth the remuneration as provided in the preceding paragraph exists, or (ii) where it is recognized under the preceding paragraph that the amount of remuneration to be paid in accordance with the pertinent provision(s) is unreasonable, the amount of the remuneration under Paragraph 3 shall be determined by taking into consideration the amount of profit to be received by the employer from the invention, the employer's burden and contribution, its treatment of the employee, and any other circumstances relating to the invention.

Due to these amendments, we expect that Japanese courts will show greater deference to corporate rules of compensation for employee inventions if the rules are prepared with due process in terms of (i) consultation with employees, (ii) disclosure of the rules, and (iii) hearing views from employees. However, it is as yet unclear what type of "consultation" or other procedures will validate an employer's remuneration criteria so as to avoid judicial scrutiny of their reasonableness. To provide guidelines regarding the boundary of acceptable practices, the Japan Patent Office published "Case Studies of the Procedures under the New

Employee Invention System" in September 2004. However, those guidelines have not been tested in court.

Despite the hope of the Japanese business community that the amendments to Article 35 would eliminate uncertainty, questions remain. The fundamental structure of Article 35 remains unchanged, and therefore, a Japanese court still may override employment regulations and award what the court regards as reasonable remuneration pursuant to Paragraph 5 if the court believes that the amount of remuneration provided by the company's internal regulations was unreasonable or was not arrived at through "due process." It remains to be seen whether courts will accept properly negotiated remuneration criteria as a limit and how deferential courts will be to such negotiated criteria. Further, the amendments apply only to rights to obtain patents or patent rights assigned on or after April 1, 2005. Therefore, employers still face the risk that aggrieved employee inventors may file lawsuits seeking remuneration pursuant to the old Article 35.

#### CONCLUSION

Foreign corporations with R&D facilities in Japan need to be thoroughly familiar with Article 35 and with the internal procedures and rules that should be followed to minimize the risks of a lawsuit from a disgruntled employee inventor. The cost of ignorance is high, and it is increasing; following the Supreme Court's decisions in *Olympus* and *Hitachi*, patented inventions commercialized globally may result in multimillion-dollar employee remuneration awards. In a country increasingly open to litigation, and where the custom of lifetime employment has eroded, the threat and incidence of such lawsuits are on the rise.

*Employers beware.* ▶▶

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