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Japan
How firms should pay 'reasonable value' to employee-inventors

Introduction

In January 2004 the Tokyo District Court issued a surprising decision concerning employee inventions. The lawsuit was brought by Shuji Nakamura, the inventor of blue-light-emitting diodes, against his former employer, Nichia Corporation, a closely held Japanese chemicals company, for the payment of 'reasonable value' for his invention. The court determined that the reasonable value to be paid to Nakamura for the invention's transfer was approximately ¥60 billion (although the actual amount awarded was ¥20 billion, which was the amount demanded by Nakamura; it was also the largest amount to have been awarded in such a case at that date).

Around the same time, two other decisions also resulted in significantly large awards for reasonable value. One was the Tokyo High Court's decision against Hitachi, Ltd, in which it awarded ¥170 million. The other was the Tokyo District Court's decision against Ajinomoto, Co, Inc, which resulted in an award of ¥200 million.

These decisions had a significant impact on this area of law, prompting many lawsuits demanding payment of reasonable value under the employee invention system. Many related issues have been vigorously argued in the meantime.

In cases where employees or ex-employees demand payment of reasonable value for their inventions, the method of calculating reasonable value is one of the main issues to come under discussion.

Although the debate surrounding these issues has lessened somewhat in recent years, two second-instance decisions from the IP High Court in 2009 involving the calculation of reasonable value – one against Canon, Inc, and the other against Brother Industries, Ltd – have attracted a great deal of attention. These two judgments granted a larger amount of reasonable value compared to previous judgments, as they used a different method to calculate reasonable value.

These cases have brought the method of calculating reasonable value once again into the spotlight. This chapter provides a discussion of the employee invention system in Japan and reasonable value under this system.

The employee invention system in Japan

Japan has a unique employee invention system under its Patent Law. Under the law, when an employee creates an invention in the course of performing his or her professional duties, the right to obtain a patent for the invention rests with him or her. However, the employer is automatically granted a free, non-exclusive licence to use the invention because it made contributions to it by employing the employee, providing research facilities and bearing the research and development (R&D) costs. In addition, the employer is allowed to reserve succession to the right to obtain the patent or patent right (or obtain an exclusive licence under the Patent Law (*Senyo Jisshiken* or *Kari Senyo Jisshiken*)) regarding the invention if this is provided in the relevant employment regulations, other stipulations and/or contracts.

If an employer succeeds to the right from the employee-inventor (or obtains an exclusive licence), the employee-inventor can demand payment of a reasonable value in return for the succession of the right (or the exclusive licence). If the amount actually paid to the employee is below the reasonable value, the employee can demand payment of the difference. The court decisions referred to in the introduction above are lawsuits in which an employee-inventor had demanded that his or her former employer pay the difference between the reasonable value and the actual amount paid.

The employee invention system – which grants employers a non-exclusive licence and right to reserve succession and awards reasonable remuneration for inventions created by employee-inventors – was designed to create and give incentives to employees to innovate and invent. It was also intended to incentivise employers to invest in employee inventions and, eventually, to encourage investment in R&D activities, and to coordinate the interests of employers and employees in order to achieve these aims.

In practice, many companies in Japan have established employment regulations or other provisions which allow them to succeed to the right regarding an employee invention. Before the recent decisions to award significantly larger amounts were made, the amounts paid to employee-inventors in terms of succession were relatively small. However, due to the non-litigious nature of Japanese people and the relationship between employees and employers in a system in which lifelong employment is still common, there were few lawsuits regarding reasonable value in the past.

How to calculate reasonable value?

The meaning of the phrase 'reasonable value' is unclear. In judicial practice, the reasonable value of an invention made by an employee-inventor is calculated using the following formula:

[the employer's profit from the invention] ×
[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.

The amount of the employer's profit is not the whole profit earned by the employer using the invention; it is rather limited to the profit that the employer earned by using the right and excluding third parties from using the invention. This is because employers can use the invention without succeeding to the right under the non-exclusive licence granted by the Patent Law, and there is substantially no different opinion on this point. However, it is not easy to determine the employer's profit. There are several legal issues concerning the determination of reasonable value, most of which involve calculating the amount of the employer's profit. For instance, the following are the issues discussed:

- whether the situation after the invention was created should be taken into account when determining the amount of the employer's profit;
- when the employer's profit should be recognised;
- whether prosecution history should be taken into account when determining the amount of the employer's profit;
- how to determine the employer's profit if the employer grants a cross-licence or blanket licence to third parties;
- how to determine the employer's profit if there are grounds for invaliding the patent regarding the invention;
- how to determine the employer's profit if the employer waives its right to obtain the patent regarding the invention;
- whether profit which accrued outside Japan should be included in the employer's profit; and
- how to determine the employer's profit when it grants a licence to others, but also uses the invention for itself.

In 2009 both *Canon* and *Brother Industries* dealt with the issue of how to determine the amount of employer's profit when the employer grants a licence to others but also uses the invention for itself. As the amount of the employer's profit is limited to the profit that the employer earned by using the right and excluding third parties from using the invention, some commentators argue that there is no such profit in amounts earned by the employer using the invention for itself. The first instance decisions in both cases determined the amount of the employer's profit to be relatively small or zero based on the existing method of calculation. However, on appeal, the IP High Court determined a higher amount, based on a new method of calculation.

Since those issues are still being discussed, it is not easy for employers to predict how much money they will be ordered to pay an employee-inventor who files a lawsuit for payment of reasonable value.

It is beyond the scope of this chapter to include a detailed examination of the discussions regarding each legal issue. However, there are two basic views regarding the Japanese employee invention system and the right to demand reasonable value which affect the answers to the issues.

The first view holds that the employee invention system is designed to provide incentives for employees to innovate and invent, and for employers to invest in inventions.

The second view holds that the system is designed to distribute some of the profits which employers derive from employee inventions to those employees. According to the first view, not all of the employer's profit should necessarily be available to distribute to employees. According to the second view, all the profit should be distributed to the employees. For instance, with respect to the issue of how to determine the amount of the employer's profit where there are grounds to invalidate a patent, according to the first view, the employer is not necessarily required to pay the profit it earned from the invention because the payment of reasonable value does not result in incentives to create patentable inventions. On the other hand, according to the second view, employers should pay employees a part of the profits from their inventions, regardless of whether they are patentable.

Both *Canon* and *Brother Industries* are now being appealed before the Supreme Court. It is hoped that in future, the courts – including the Supreme Court in these two cases – will clearly provide answers to the issues and set out the logic of their answers regarding the calculation of reasonable value.

What should companies do regarding employee inventions?

Unpredictability regarding how much a company may be ordered to pay to its employee or ex-employee as reasonable value for an invention may present an obstacle for the company in considering its management strategies, and also for those intending to acquire such companies through mergers and acquisitions.

How can companies take measures to lower the risk of lawsuits? After some court decisions granting large amounts of reasonable value and heated debate over the employee invention system and reasonable value, the provisions of the Patent Law on the employee invention system have been revised. The revisions are designed to place more importance on procedure and transparency regarding the determination of reasonable value in a company.

Under the revised provisions, if the amount of consideration of transfer of an employee invention is determined in accordance with standards provided in a contract, employment regulations or other stipulations, then it is likely that the determined amount will be considered to be reasonable provided that the payment thereof is considered to be reasonable when considering whether:

- adequate consultation has taken place between employer and employee to set those standards;
- the standards have been properly disclosed; and
- the employer has adequately heard employees' opinions regarding those standards.

Following this revision, the predictability of reasonable value for employers is more certain. Hopefully, it will also result in employees being more satisfied with the fruits of their labour. Therefore, in order to lower the risk of lawsuits and the risk of paying substantially large sums of reasonable value, companies should set rules concerning the value to be paid to employees through proper procedures and operate such rules in a fair and transparent manner.

Since the concept of reasonable value remains, it is possible that a company might be ordered to pay additional amounts if a payment of the value already made to the employee-inventor is deemed to be unreasonable. Therefore, companies are advised to keep a close eye on trends in future court decisions, such as the upcoming Supreme Court decisions in *Canon* and *Brother Industries*.

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