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WINDS FROM JAPAN

The Licensing Executives Society Japan

Amendment to the Civil Code and its Impact on IP License Agreements

By Yusuke Inui*

1. Introduction

On May 26, 2017, the Diet passed a bill that partially amends the Civil Code (the "2017 Amendment"). The 2017 Amendment is largely scheduled to take effect on April 1, 2020. (Hereinafter, the Civil Code as amended by the 2017 Amended is referred to as the "amended Civil Code", and the Civil Code prior to the amendment is referred to as the "former Civil Code.")

Since the enactment of the Civil Code in 1896, the Civil Code went through some minor amendments, but the basic structure of the Civil Code remained unchanged (except for provisions relating to domestic relations and inheritance, which were significantly changed by an amendment in 1947). However, the 2017 Amendment dramatically changes the provisions of the Civil Code that relate to claims and obligations, and especially those that relate to contracts. The main purpose of the 2017 Amendment is to align the Civil Code with the modern Japanese society and economy, and to reflect and incorporate case law and interpretations that were developed since the enactment of the Civil Code.

The Civil Code lists certain types of contracts as "typical contracts", and has provisions that directly regulate such typical contracts. However, the former Civil Code does not list license agreements on intellectual property rights ("IP license agreement(s)") as one of such typical contracts, and does not have any provisions that directly regulates IP license agreements. During the process of drafting the bill of the 2017 Amendment, there was a proposal to add IP license agreements as one type of typical contract. However, the proposal was ultimately rejected, because there were comments from the public that it was not necessary to regulate IP license agreements in the Civil Code. As a result, the 2017 Amendment passed by the Diet does not contain any provisions that directly regulates IP license agreements.

Nevertheless, it is likely that the 2017 Amendment has some impact on IP license agreements. This article introduces some parts of the 2017 Amendment that are likely to be relevant to IP license agreements.

2. 2017 Amendment's Impacts on IP License Agreements

(1) Late Payment Interest

Under the former Civil Code (and also the Commercial Code prior to the 2017 Amendment), a standard interest rate that applies to late payment under a contract between business people or entities is 6% per annum, unless the contract sets a different interest rate (Article 514 of the Commercial Code). However, there was a criticism that this rate was too high compared to the low interest rate in the actual financial market.

The 2017 Amendment lowers the standard rate to 3% per annum. Further, this standard rate is subject to change every three years in order to reflect changes of interest rate in the financial market (Article 404 of the amended Civil Code).

Under an IP license agreement, the licensee often has an obligation to pay royalties to the licensor. If the licensee fails to pay the royalties in a timely manner, the licensee will be charged late payment interest. The interest rate applicable to such late payment interest will become 3% under the amended Civil Code, if the IP license agreement does not set a different rate.

Therefore, if parties to an IP license agreement wish to apply a different interest rate, it would be necessary to expressly state the different rate in the IP license agreement.

(2) Prescription (Statute of Limitations)

Under the former Civil Code, the general rule of prescription (Statute of Limitations) provided in the Civil Code and the Commercial Code is as follows: (A) a claim (e.g. a right to seek payment) that arises from a commercial act shall extinguish after five years from the time when it becomes possible to enforce the claim (Article 522 of Commercial Code); and (B) a claim that does not arise from a commercial act shall extinguish after ten years from the time when it becomes possible to enforce the claim (Article 167(1) of the former Civil Code). Also, the former Civil Code set certain shorter prescription periods for certain types of claims. However, there was a criticism that the rules were too complicated.

The 2017 Amendment changes these rules. Under the amended Civil Code, a claim shall extinguish if either one of the following events occurs: (A) five years pass from the time when the creditor (holder of the claim) becomes aware that it is possible to enforce the claim; or (B) ten years pass from the time when it becomes possible to enforce the claim (Article 166(1) of the amended Civil Code). This rule applies regardless of whether the claim arose from a commercial act or not.

Under an IP license agreement, the licensee often has an obligation to pay royalties to the licensor. If the licensee fails to pay royalties in timely manner, it is likely that the licensor will immediately become aware of the fact that the licensor is able to enforce the claim of royalty against the licensee. Therefore, it is likely that the prescription period in this case is five years from the payment due date under the amended Civil Code. In other words, if the licensor fails to enforce the royalty claim within five years from the payment due date, the licensor will no longer be able to seek payment of the royalty from the licensee.

(3) Termination Due to Breach of Contract

Under the former Civil Code, in case a party to a contract does not perform its obligations, if the other party demands performance of the obligation but the obligation is not performed within a reasonable period, the other party is entitled to terminate the contract (Article 541 of the former Civil Code).

The amended Civil Code retains this basic rule. However, under the amended Civil Code, if the non-performance of the obligation is minor in light of the contract and social convention of trade, the other party may not terminate the contract (Article 541 of the amended Civil Code).

Under an IP license agreement, the licensor has an obligation to allow the licensee to use the intellectual property licensed under the agreement, and the licensee often has an obligation to pay royalties to the licensor. Since such obligations are the core of the IP license agreement, it is likely that breach of these obligations would be considered as a material breach (non-minor breach) and would trigger the right to terminate the license agreement.

However, there could be other obligations under an IP license agreement (e.g., an obligation to give notice to the other party under certain circumstances), and it is possible that non-performance of such obligations could be considered minor and thus would not trigger a termination right.

Therefore, it would be advisable that the parties clarify in the agreement, which non-performance triggers the termination and which does not.

(4) Defect Warranty

Under the former Civil Code, a seller in a sale and purchase contract had an obligation named "defect warranty". Namely, if there is a hidden defect in the item to be sold, the buyer was entitled to seek damages and/or terminate the contract (Article 566 of the former Civil Code).

Under the amended Civil Code, instead of a defect warranty, the seller has an obligation to deliver an item that conforms to the contract regarding type, quality and quantity of the item. If the seller fails to perform this obligation, the buyer is entitled to seek repair or replacement of the item, as well as seek damages and/or terminate the contract (Article 562 of the amended Civil Code).

There was an argument under the former Civil Code as to whether a defect warranty applies to IP license agreements. One argument was that if the IP right that is licensed under an IP license agreement is later declared invalid, or if the licensed product is found to infringe an IP right owned by a third party, then a defect warranty applies *mutatis mutandis* and the licensee is entitled to seek damages and/or terminate the IP license agreement. However, it was unclear whether such an argument was the correct interpretation of the former Civil Code.

The 2017 Amendment did not make this point clear. Thus, it would be advisable that the parties clarify in the IP license agreement, whether such event will constitute breach of warranty by the licensor, and what remedies the licensee will be entitled to in case of a breach.

(5) Assignment of Claim

Under the former Civil Code, a holder of the claim (creditor) was able to assign the claim to a third party without the debtor's consent. However, it was also possible to make a claim non-assignable by an agreement of the creditor and the debtor (Article 466 of the former Civil Code).

Under the amended Civil Code, even if the creditor and the debtor agree to make the claim non-assignable, assignment of the claim by the creditor is still effective. However, if the assignee of the claim knows, or does not know by gross negligence, that there was such an agreement between the creditor and the debtor, then the debtor is able to refuse performance of the obligation against the assignee (Article 466(1) of the amended Civil Code).

Under an IP license agreement, the licensee often has an obligation to pay royalties to the licensor. The licensor is free to assign the claim (the right to seek payment of royalties from the licensee) to a third party, unless the IP license agreement provides otherwise. However, under the amended Civil Code, even if there is a provision in the IP licensee agreement that prohibits the licensor from assigning a claim to a third party, an assignment of a claim made in violation of such a provision is still effective. Therefore, if the parties wish to prevent such assignment of claims, it would be advisable that the parties expressly state that such assignment would become a grounds for termination of the IP license agreement.

3. Conclusion

As explained above, while the 2017 Amendment does not contain any provisions that directly regulate IP license agreements, it is likely that the 2017 Amendment has some impacts on IP license agreements.

In the meantime, it is also likely that the actual impact of the 2017 Amendment is relatively small in practice. This is because most provisions of the Civil Code (including those revised by the 2017 Amendment) that relate to contracts usually apply only when the contract does not provide for the issues covered by such provisions (except for certain provisions that apply regardless of whether the contract addresses such issues, such as prescription). IP license agreements tend to be well-written and detailed, and tend to address most of the major issues that could arise during the life of such agreements. Therefore, there is relatively little room for the Civil Code to apply to IP license agreements, compared to other types of contracts (such as sale and purchase contracts).

Going forward, while it is of course important to fully understand the provisions of the Civil Code that were revised by the 2017 Amendment, it is also important that the parties negotiating an IP license agreement address all major issues in the agreement in an express and unambiguous manner, in order to avoid unexpected consequences arising from the 2017 Amendment.

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Higher Compensation for Damages to Patentees

IP High Court Grand Panel Decision on June 7, 2019
and 2019 Patent Act Revision

By Mitsuo Kariya *

There was a lot of criticism that the damages awarded by the courts were low in Japan. The IP High Court rendered a grand panel decision which clarified the criteria for calculating patent infringement damages based on Patent Act Article 102 paragraphs (2) and (3). These criteria are expected to help patentees to receive higher damage awards.

Patent Act Provisions and Questions needed to be answered

Article 102 paragraph (2): In order to ease the difficulty for a patentee to prove the amount of loss sustained by a patent infringement, this provision prescribes that when a patent infringer has a profit, this profit is presumed to be the loss by the patentee. In general, infringers attempt, as much as possible, to deduct various costs from their revenues to reduce the awarded damage. There was a question what costs can be deducted for deriving the profit gained by the patent infringer.

Article 102 paragraph (3): A patentee can request compensation for damages for the amount which is to be received for practicing the patented invention. This provision is considered to set the minimum level of damages. Although this provision was revised in 2008 to change from “normally received” to “received” in order to avoid an interpretation of lowering a damage compensation, there was still an assumption that a patent infringer may need to pay only an amount which is similar to the existing contracted royalty even after the patent infringer was sued.

IP High Court Grand Panel Decision

A cosmetic company owns two patents relating to a cosmetic material and sued seven cosmetic product manufacturers for patent infringements before the Osaka district court. The Osaka district court found that the defendants’ products infringe the patents and ordered injunctions and damage awards. The defendants appealed the case to the IP high court. The IP high court found that the patents are not invalid and the appellants’ products infringe the patents. The grand panel was formed to unify the judgements regarding the damages calculation.

The IP high court decided that only directly related costs can be deducted to calculate the infringer’s profit in the case of Article 102 paragraph (2). The IP high court clarified that the “profit” in Article 102 paragraph (2) is a “marginal profit” which is calculated by deducting costs which are directly related to and additionally required for manufacturing and selling the infringing products. The court stated that raw material costs, purchase costs and freight costs related to the infringing products are deductible, however labor costs and transportation/communication expenses at managing sections are not deductible. The court also stated that the costs argued by the appellants, e.g., labor costs of R&D center researchers, labor costs of part-time employees, out-sourced exam research expenses, advertising expenses, free distribution sample costs, which were not proven to be directly related to and additionally required for manufacturing and selling the infringing products, were not deductible.

The IP high court clarified that a higher rate should be naturally applied to calculate damages according to Article 102 paragraph (3) before a court when the court found that an accused infringer’s product infringes a patent, compared to the rate in an existing license agreement which was determined in view of a risk where no infringement may be found afterward. The IP high court also stated that the applicable rate according to Article 102 paragraph (3) should be determined in view of various circumstances like the value, importance and substitutability of the patented invention, the contribution of the patented invention to the infringer’s revenue and profit, the way of infringement, the competitive relationship between the patentee and the infringer, and the business policy of the patentee taking the royalty rate in an existing license agreement, the market price if no existing license agreement was found, etc., into consideration.

The IP high court awarded a damage compensation calculated by a rate of 10% of the infringing product sales which is identical to the rate which was agreed in a settlement regarding other patents in a similar technical field owned by this patentee. Other submitted evidence showed that the average royalty rate in the chemical industry was 5.3% according to the recent questionnaire survey to the domestic companies and the average royalty rate in the recent judicial decisions regarding chemical cases was 6.1%. In this decision the IP high court awarded a rate which was higher than those rates.

The 2019 Patent Act Revision

The Patent Act was revised to ensure fair damage awards to patentees by amending Article 102 paragraph (1) and adding Article 102 paragraph (4). This revision was promulgated on May 17, 2019 and will come into force on April 1, 2020.

Revised Article 102 paragraph (1): when an infringer sold infringing products the amount of loss by a patentee can be calculated as the sum of the amounts in items (i) and (ii).

(i): the product of the number of infringing products which is within the patentee's production capacity and the per unit profit when the patentee could have sold if there was no infringement.

(ii): a damage compensation according to paragraph (3) for the number of infringing products which is more than the patentee's production capacity.

By this revision it became clear that a patentee can receive compensation for the infringing product sale which is more than its production capacity. In principle, a patentee can receive a compensation for all infringing products.

Article 102 paragraph (4): A court can determine the compensation according to Article 102 paragraph (1) item (ii) and paragraph (3) by considering an agreeable amount on the premise that the patent was infringed.

By this revision it became clear that the applicable rate before a court is generally higher than a royalty rate in an existing license agreement.

Insight

Although the IP high court grand panel may have made this decision independently from the 2019 patent act revision, it would be considered that this decision falls in line with the intention of the patent act revision.

It is reported that there was a discussion whether a punitive damages system should be introduced during the process of this patent act revision, however the punitive damages system was not introduced this time. It was considered that a fair damage compensation could be achieved by increasing the damage awards without a punitive damage system.

From a licensing perspective, it is recommended to clearly distinguish a royalty rate for a voluntary licensing negotiation from that through litigation. It is expected that more potential licensees will become serious to reach agreements earlier. As the royalty rate determined by courts may become higher the value of Japanese patents will also become higher.

For the sake of simplicity, this article introduced only a related part of the court decision and the patent act revision, while other complicated parts were omitted. It is recommended to consult local professionals when you have an actual legal issue.

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LES Japan Mini-Annual Conference 2019 in Oiso

By Yasuo Fujii, Ph.D.*

Since the LES International 2019 Annual Conference was held in Yokohama, Japan in May, the LES Japan Annual Conference 2019 was designed to be compact, but valuable. LES Japan "Mini"-Annual Conference 2019 was held on the 11th and 12th of October 2019 in Oiso, Kanagawa prefecture. The meeting venue was the Oiso Prince Hotel located very close to the beautiful seaside of Sagami Bay. In the early 1900s, many people built their villas in Oiso, including famous
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people in political and business circles, such as Mr. Hirobumi Ito, the first prime minister of Japan.

The Conference started with opening remarks by Mr. Makoto Ogino, President of LES Japan. Subsequently, Mr. Hisashi Kumazaki, Chief of Intellectual Property Division, Hitachi, Ltd. addressed the audience. Mr. Kumazaki firstly introduced the transition of Hitachi, Ltd's. business, with its founding principle of "Contribution to society through the development of superior original technologies and products". Then the "2021 Mid-term Management Plan" of Hitachi, Ltd. was introduced, which includes development of "Lumada CPS (Cyber Physical System). Mr. Kumazaki finally discussed the activities for intellectual properties of Hitachi, Ltd. based on an "IP Value Pyramid" which included five layers consisting of "Defend Position" (Level 5: bottom), "Manage Costs" (Level 4), "Capture Value" (Level 3), "Synthesize Opportunities" (Level 2) and "Shape the Future" (Level 1: top).

Mr. Makoto Ogino

Mr. Hisashi Kumazaki

Soon after the speech by Kumazaki, four workshops were organized by working groups of LES Japan, where the latest topics were discussed : 1) U.S. Issues WG; 2) Industry-Government-Academia Collaboration WG; 3) ICT Business WG; and 4) IP Finance WG.


Workshop (ICT Business WG)

After the workshops, all of the participants enjoyed a banquet, while the very large typhoon was approaching the eastern part of Japan covering Oiso!

Banquet

The conference concluded successfully, providing a well-designed compact and valuable program. The LES Japan Annual Conference 2020 will be held in Otsu city, Shiga prefecture.

We look forward to seeing you in Otsu soon!

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IP News from Japan

By Shoichi Okuyama, Ph.D.*

Improved IP Protection for *Wagyu* Beef Cattle

In January 2020, the Ministry of Agriculture, Forestry and Fisheries announced plans to create a new act, with criminal penalties, against illegal purchase, sale, transfer, or acquisition overseas of "genetic resources" such as fertilized eggs and semen of *Wagyu* cattle (four specific Japanese cattle breeds).

There were no laws or regulations in place to directly control unauthorized export of genetic resources when several Japanese nationals tried to send frozen *Wagyu* semen and fertilized eggs to China. They were arrested for breaking laws on general export controls for live biological materials and were sentenced to prison.

A bill will soon be submitted to the National Diet and is expected to become law this year.

It is estimated that 400,000 of so-called "*Wagyu*" cattle are currently being raised in countries such as Australia, the United States, and Argentina. They originate from legally exported *Wagyu* cattle in the 1970s and '80s.

The new act aims to protect the genetic resources of improved *Wagyu* as intellectual property.

JFTC Looking at Major IT Vendors

The Japan Fair Trade Commission (JTFC) has reportedly launched a survey among banks and fintech companies regarding the slow rollout of non-cash payments in Japan.

The study is also directed at major IT vendors, such as NTT Data, which are allegedly trying to maintain the existing fee structures for the use of the system supporting consumer transactions. Last November, a questionnaire, "Survey on Cashless Payment and Household Account Service", was sent to banks and fintech companies. A report is expected to be published in March of this year.

In several recent media reports, it was alleged that such IT vendors have become a bottleneck to the widespread use of non-cash payments in Japan. The percentage of non-cash payments in Japan was as low as 20% in 2016.

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Editors' Note

This issue includes articles, "Amendment to the Civil Code and its Impact on IP License Agreements" by Mr. Yusuke Inui, "Higher Compensation for Damages to Patentees" by Mr. Mitsuo Kariya, "LES Japan Mini-Annual Conference 2019 in Oiso" by Mr. Yasuo Fujii, and "IP News from Japan" by Mr. Shoichi Okuyama.

Thank you for supporting "*WINDS from Japan.*" This newsletter will continue to provide you with useful information on activities at LES Japan and up-to-date information on IP and licensing activities in Japan.

If you would like to refer to any back issues of our newsletters, you can access them via the following URL:

https://www.lesj.org/en/winds/new.php

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