

# Protection of Patent License Against Subsequent Patent Holder in Japan

Professor, Univ. of Tokyo  
Attorney at Law

Shinto TERAMOTO

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## I. WHY AM I DISCUSSING THE TITLED ISSUE?

I have been practicing as a finance lawyer for over twenty years in Japan. Among various fields of finance practices, I specialize in venture capital finance and intellectual property focused finance. These areas of practice are characterized by the synergy of finance laws and intellectual property laws. Those who practice in this area of law are required to have deep insight into both finance and IP laws, as well as a wide scope of related laws. Among all, the impact of a bankruptcy on intellectual property rights (hereinafter, "IP rights") or assignment of IP rights to parties of license and other intellectual property transactions are of much importance. I believe it is essential to introduce students to this jungle of business laws.

## II. INTRODUCTION TO THE ISSUE

### A. *Assumptions of Transactions to Be Discussed*

I would like to give readers a quick tour of a small but very important corner of the Japanese patent system. I would like to show readers how and to what extent the patent licensee is protected against the assignee of relevant patent rights or the receiver in the event of bankruptcy of the patent holder.

Please imagine that a patent holder, who is the licensor, grants a license to a licensee (Fig.1). Under the license, the licensee is granted the right to practice the patented invention in accordance with the terms and conditions of the license agreement executed between the licensor and the licensee. Then, assume that the licensor assigns the patent rights to a third party (Fig.2). Or, assume that a creditor of

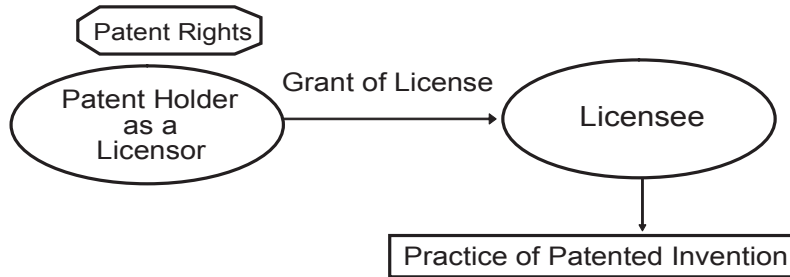
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\* This article is based on a lecture by the author on August 2, 2007 during the Summer School 2007 at the University Of Tokyo School of Law.

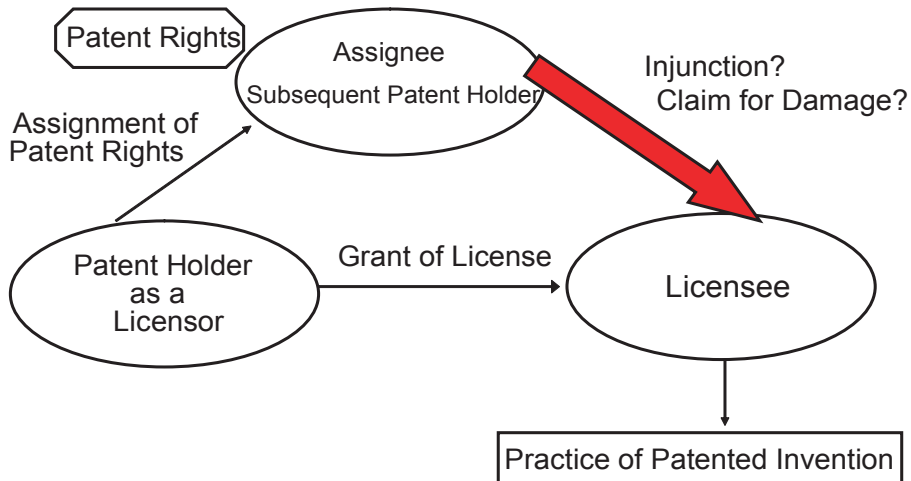
the licensor attaches patent rights through a civil procedure, and a third party acquires the patent rights through a compulsory auction (Fig.3). Or assume

that the licensor goes bankrupt, and the receiver in bankruptcy begins to manage and control the patent rights (Fig.4).

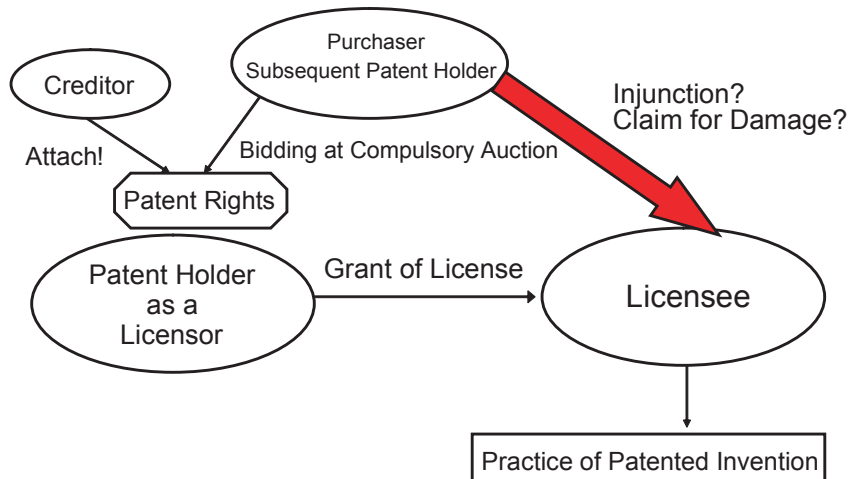
(Fig.1 Typical Patent License)



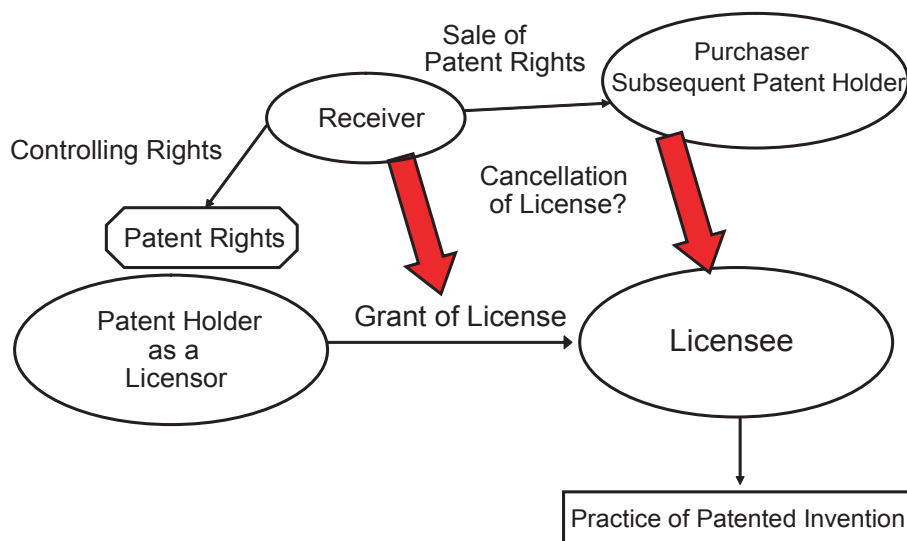
(Fig.2 Patent Rights Assigned to a Third Party)



(Fig.3 Compulsory Auction of Patent Rights)



(Fig.4 Licensors Goes Bankrupt)



*What Are the Concerns of B. the Subsequent Patent Holder or the Receiver?*

What are the concerns of the assignee or the receiver in these cases? What do you expect, if you are the assignee or the receiver? You hope that the patent rights are subject to no existing license. Why? Any burden of license to the patent rights may decrease the value of the rights. This mechanism is very simple. Patent rights have power to exclude others from the practice of a patented invention (Article 68 of the Patent Law of Japan (Law No. 121 of 1959, as amended)). However, what will happen if there is an outstanding license arrangement regarding patent rights? The patent holder cannot bar the licensee’s practice of the patented invention (e.g., Article 78 of the Patent Law of Japan). Thus, the exclusive power of the patent rights is diminished. Accordingly, the outstanding license will reduce the value of the patent rights. Conclusively, the assignee or the receiver expects that the license will no longer exist on and after the transfer of the patent rights from the assignor or the bankrupt patent holder.

Undoubtedly, the assignee or the receiver expects that he/she can get money (or, any similar economic

benefit) from the patent rights. Let us think how you can gain financial benefits from patent rights? One method is for an assignee or receiver to grant a license to any third party, and to be paid royalties from that party. Another method is to sell the patent rights to any third party. Assume that you are the new licensee or the new purchaser of the relevant patent rights. You will not be happy with paying expensive royalties or the full purchase price unless you can monopolize the practice of the patented invention. Accordingly, the value of patent rights, represented by the potential royalties or purchase price, reduces, if the patent rights are subject to an outstanding license arrangement.

Naturally, the assignee or the receiver expects that the existing licensee cannot claim licensee’s rights against such an assignee or a receiver. The assignee or receiver hopes that he/she can request an injunction against the practice of the patented invention by the existing licensee.

*C. What Are the Concerns of the Existing Licensee?*

Now, we are going to discuss the concerns of the existing licensee. What do you desire, if you are

the existing licensee? How do you wish the legal system to protect your position as an existing licensee against the assignee or the receiver? It would be easy to imagine that you would desire to continue the practice of the patented invention.

#### D. *Material Conflicts of Interest*

Here, you will find material conflicts of interest between the assignee or the receiver of the patent rights (hereinafter, collectively, “the subsequent patent holder”), and the existing licensee.

The best scenario for the subsequent patent holder is that the patent rights acquired would no longer be subject to any license. The second best scenario is that any existing license, to which the patent rights are subject, is recognizable and assessable by the subsequent patent holder prior to acquisition of the patent rights. In order to achieve this, the subsequent patent holder desires that any such existing license be publicly registered. The subsequent patent holder expects that no license be claimed against him/her unless it is publicly registered.

On the other hand, the existing licensee expects that he/she can claim his/her licensee’s rights against any subsequent patent holder, with as little cost and labor as possible, and, hopefully, with as little information as possible publicly disclosed. As you may know, registering a patent license at the Japan Patent Office for individual patent rights requires considerable labor and cost (Article 27, Paragraph 1, Item 2, and Article 98, Paragraph 1, Item 3 of the Patent Law of Japan; Article 45, Paragraph 1 of the Order concerning Registration of Patent (*Tokkyo Toroku Rei*, Cabinet Order No. 39 of 1960, as amended); and Article 2, and Exhibit 1, Item 13 (2) of Registration License Tax Act (Law No. 35 of 1967, as amended)).

### III. VARIATION OF PATENT LICENSE UNDER THE PATENT LAW OF JAPAN

#### A. *Scope of Discussion*

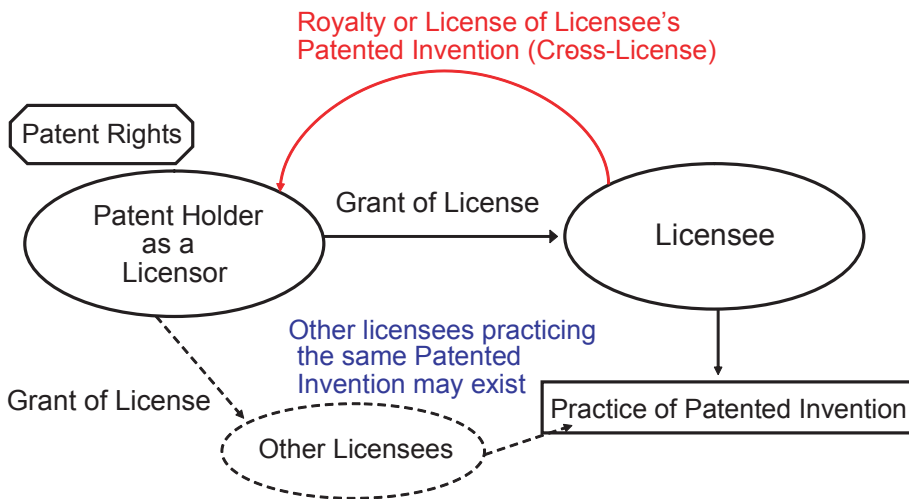
In this article, I do not discuss any statutory or compulsory license under the Patent Law of Japan (See *e.g.*, Article 35, Paragraph 1, Article 79, Article 80, Article 81, Article 82, Article 83 of the Patent Law of Japan). A great majority of patent licenses start based on a license agreement between the patent holder as a licensor and a licensee who desires to practice the patented invention. Of course, a licensor can set up a sub-license arrangement with a sub-licensee. However, to simplify the discussion herein, I will focus on a case wherein the licensor is the patent holder.

#### B. *Non-Exclusive License (Fig.5)*

##### 1. Ordinary Form of a License

A non-exclusive license is the simplest and most common style of patent license, wherein the patent holder grants a licensee to practice a certain patented invention, or a certain scope of patented inventions. The essence of such a license arrangement is that the patent holder covenants that he/she will not request an injunction or compensation for damages when the licensee practices the patented invention or inventions. Usually, in consideration of such covenants, the licensee agrees to pay royalties to the patent holder. However, a royalty is not the sole mode of compensation. Sometimes, the licensee has another patent or another set of patents. Then, the licensee may grant the licensor a license of his/her patented invention or inventions. Such a second license may constitute a consideration of the first license. Such a license arrangement is often called as a “cross-license.”

(Fig.5 Non-Exclusive License)



2. What Does “Non-Exclusive” Mean?

Under a non-exclusive license, the licensor is not prohibited from granting any other party a license for the same patented invention. In other words, the licensor may grant any other party a concurrent license for the same patented invention. This is the legal meaning of a “non-exclusive license.” Accordingly, the licensee of a non-exclusive license is expected to be aware of a possibility that one or more competitors practicing the same patented invention or inventions may exist.

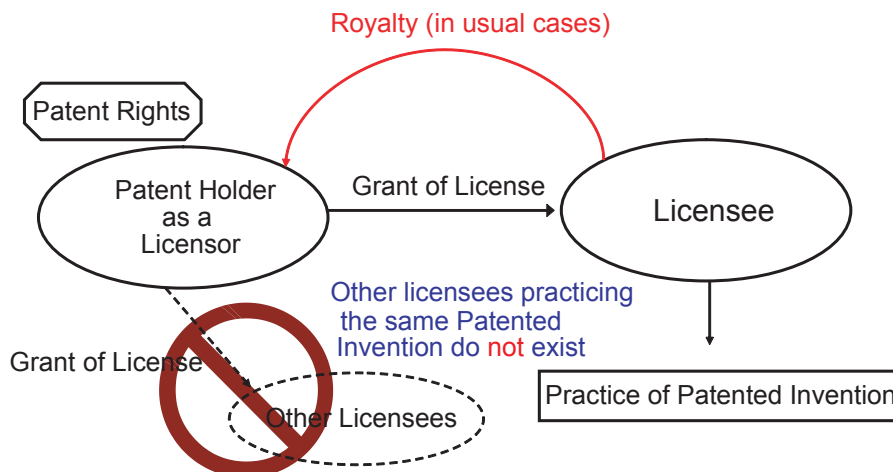
lar to that of a non-exclusive license. However, one factor distinguishes an exclusive license remarkably from a non-exclusive license. What is this factor? In an exclusive license, the licensor covenants that he/she will not grant a license to any party other than the licensee to whom the exclusive license is granted.

C. Exclusive License (Fig.6)

In reality, there are variations in the exclusivity. A licensor may give a licensee exclusive rights within every business or technological field and in every geographical area -- namely, any and all areas in Japan. A licensor may also give a licensee exclusive rights within a certain business or technological field (such as development, manufacturing and sale of a business- or home-use printer). Or, a licensor may grant a licensee exclusive rights within a certain

The structure of an exclusive license is simi-

(Fig.6 Exclusive License)



geographical area, such as Hokkaido Region of Japan. All of these fall within the category of exclusive license.

*D. What Are the Concerns of the Licensee?*

The licensee desires to avoid being subject to an injunction or demand for compensation for damages due to his/her practice of a patented invention. This is the exact reason that the licensee enters into a license agreement with a patent holder.

Generally, any service contract may be subject to an adverse effect caused by a bankruptcy of a service provider or an attachment of an asset of the service provider by its creditor. If the receiver of a service provider's bankruptcy terminates the contract, the counter-party can no longer enjoy the service which should have been provided under the service contract. If a creditor attaches an asset essential to providing such a service, the counter-party can no longer expect the continuation of the service.

What happens if the service contract is a patent license agreement? The licensee's situation may become a real nightmare. The licensee may have contributed no small investment towards the development and manufacturing of the product utilizing the licensed invention. The licensee may have already publicized his/her business plan utilizing the licensed invention to the potential or existing investors in the

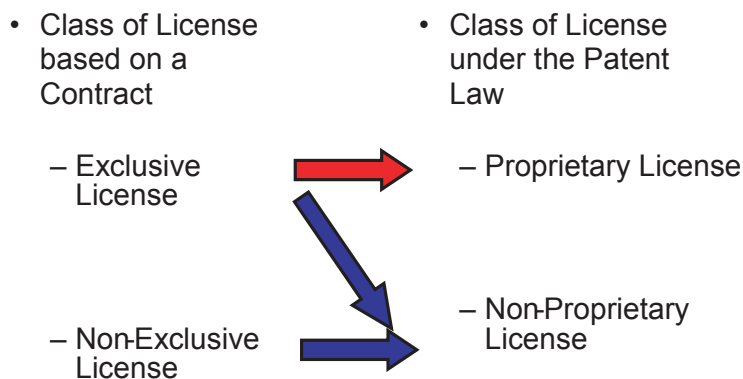
business, as well as customers, etc. The licensee may also have already received cash investments from institutional or individual investors. The impact of the termination of the licensee's rights will not be acceptable to him/her and his/her investors.

Given these impacts on the licensee, balancing the interests of both the licensee and the assignee of patent rights is important. Assume that you are the assignee of the patent rights and that you are not given a chance to determine if there is any existing license; you may have good reason to refuse the existing licensee's claim to continue to practice the patented invention. However, if you had a sufficient opportunity to determine if there was any existing license, it is not unreasonable for you to be subject to the existing license.

**REGISTRATION OF LICENSEE'S RIGHTS UNDER THE PATENT LAW OF JAPAN (Fig.7)**

Let us glance at the registration system of a patent license under the Patent Law of Japan. The key terms are "non-proprietary license" and "proprietary license." These terms may be new to some readers. Most people use the terms "exclusive and non-exclusive license" to express the concept of the two types of license under the Patent Law. The Japan Patent Office also uses the terms "exclusive and non-exclusive license." However, I do not use these terms here.

(Fig.7 Registration of a Licensee's Rights under the Patent Law of Japan)



The following discussion will demonstrate my own concepts and use of terms:

### A. Non-Proprietary License

#### 1. Provisions of the Patent Law of Japan

The discussion here is related to the provisions of the Patent Law of Japan, as itemized below:-

##### Article 27 (Registration in the Patent Registry)

1. The following matters shall be registered in the patent registry maintained in the Patent Office:  
...  
(ii) the establishment, maintenance, transfer, modification, lapse or restriction on disposal, of a proprietary or non-proprietary license; and ...

##### Article 78 (Non-Proprietary License)

1. A patent holder may grant a non-proprietary license for the patent rights to any other party.
2. A non-proprietary licensee shall provide a right to practice the patented invention as a business to the extent prescribed by this Act or permitted by the contract granting the license.

##### Article 99

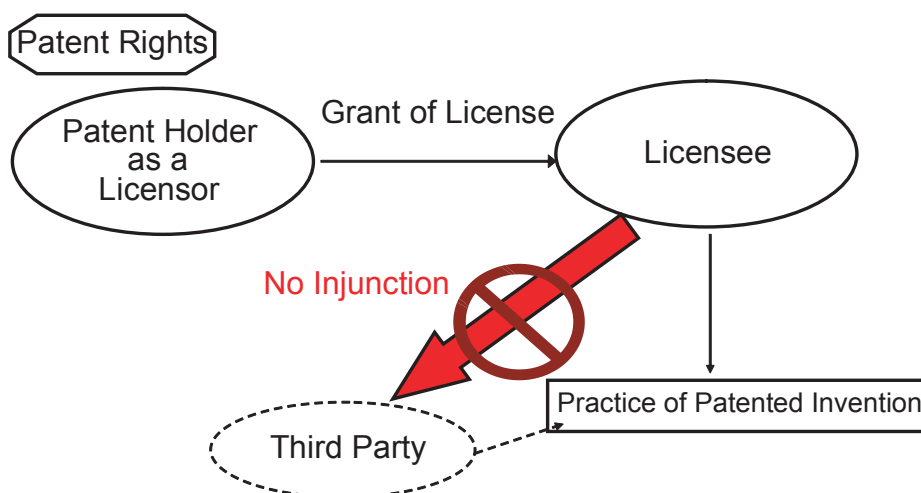
1. When a non-proprietary license is registered, the non-proprietary license shall have effect on any person who subsequently acquires the patent rights or the proprietary licensee, or the proprietary license on the patent rights.  
....

#### 2. What Is a Non-Proprietary License? (Fig.8)

A non-proprietary license under the Patent Law means a license, wherein the licensee has no power to exclude third parties from practice of the patented invention that is the subject of the license arrangement. The essential part of the rights of a non-proprietary licensee is that he/she can prevent the patent holder from prohibiting his/her practice of the patent rights by such means as an injunction or a demanding for compensation for damages.

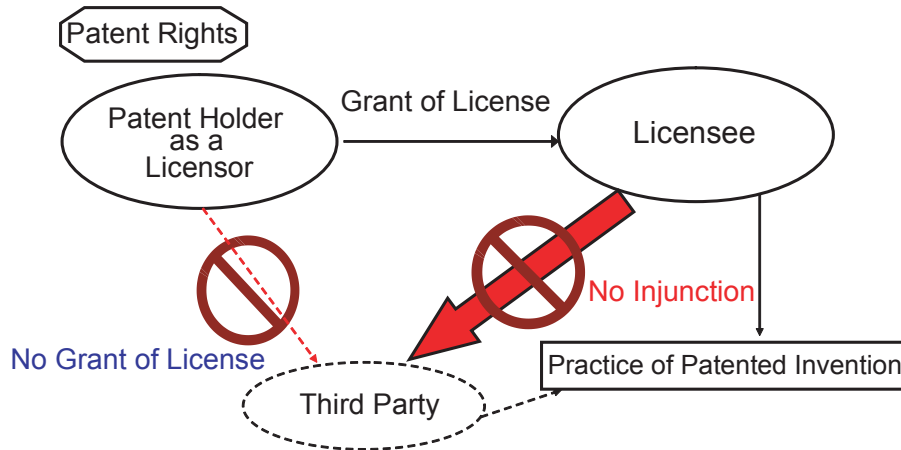
Please note that a non-proprietary license under the Patent Law can be an exclusive license under a license agreement (Fig.9). In such a case, the licensee can require the licensor not to grant license to any other party. However, the licensee cannot request an injunction against any other party practicing the licensed invention.

(Fig.8 What Is a Non-Proprietary License?)





(Fig.9 A Non-Proprietary License Which Is an Exclusive License)



3. What Is a Proprietary License? (Fig.10)

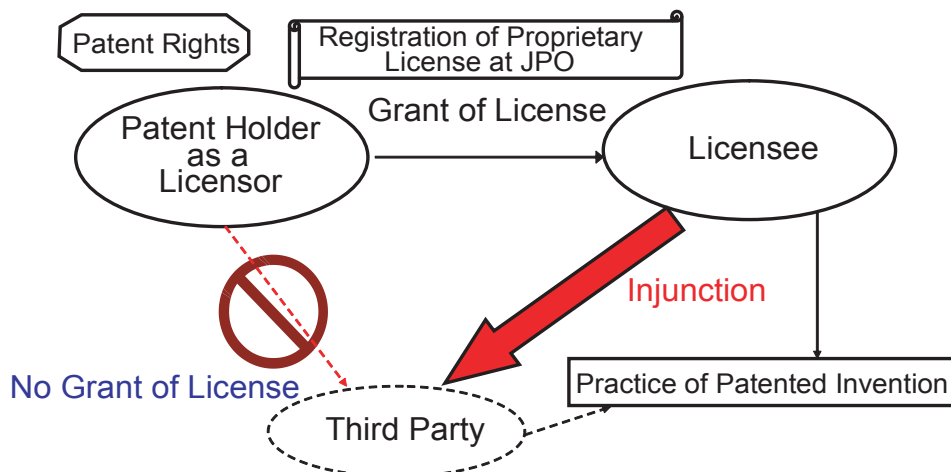
Of course, some exclusive license agreements obligate the licensor to register the proprietary license at the Japan Patent Office so that the licensee can obtain the rights to ask for an injunction against a third party practicing the licensed invention. Such power of the licensee is created only by the registration of the proprietary license at the Japan Patent Office. No contract between the licensor and the licensee can create such power without registration. This is why I would like to distinguish the term (a “proprietary license”) used to mean such a license provided for under the Patent Law, from the term (an “exclusive license”) used to mean the license created

by a contract which provides an exclusive right to the licensee but no proprietary right. The discussion herein focuses on a non-proprietary license.

B. *Benefits of Registration of a Non-Proprietary License*

Any party may acquire patent rights subsequently after a licensee obtains a non-proprietary license for the same patent rights. As I suggested before, the licensee hopes that he/she can claim his/her licensee’s right against such subsequent proprietors. The registration of a non-proprietary license at the Japan Patent Office gives the licensee such a power.

(Fig.10 What Is a Proprietary License?)



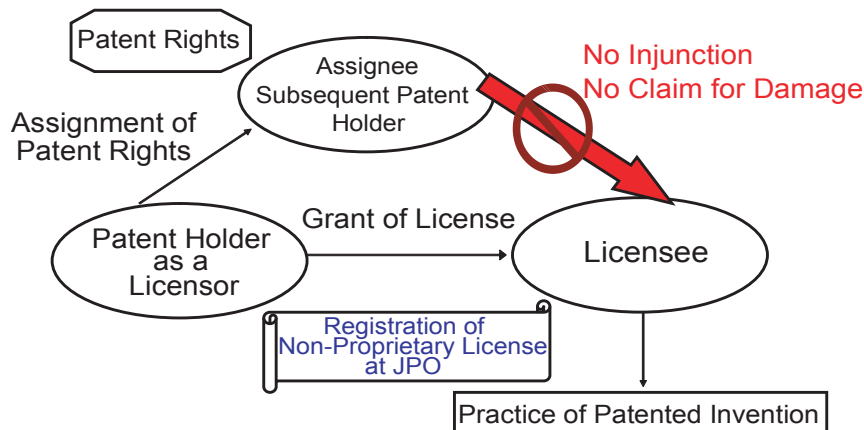
Specific or typical cases of such a transaction are itemized below.

1. (Fig.11) Assume that the licensor transfers his/her patent rights to a third party. There is a concern that the third party assignee would attempt to enforce the patent rights against the existing licensee. If the non-proprietary license of the existing licensee is registered at the Japan Patent Office, then such an attempt will fail, because the existing licensee can claim registered licensee's rights against the subsequent proprietor.
2. (Fig.12) Otherwise, assume that the receiver of the licensor's bankruptcy disposes of the patent rights, and a third party purchases the rights.
3. (Fig.13) Another case assumes that a creditor of the original licensor attaches the patent rights, and

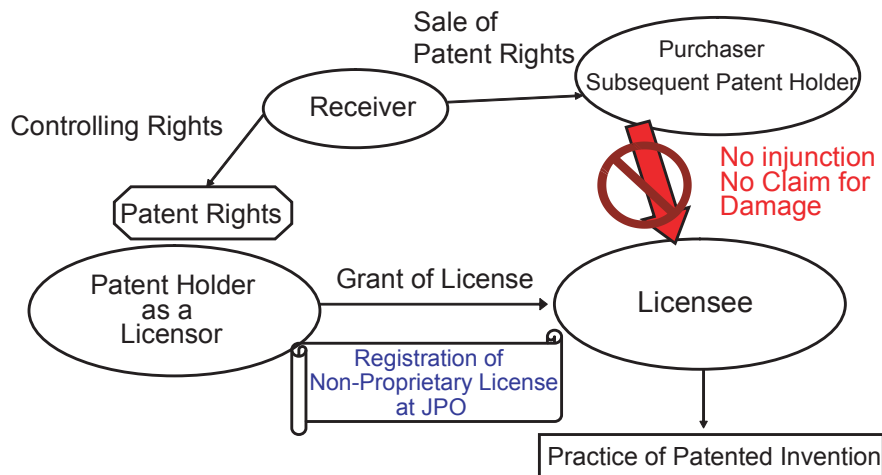
a third party acquires the rights through a compulsory auction. There is a concern that the third party acquirer would attempt to enforce the patent rights against the existing licensee. If the non-proprietary license of the existing licensee is registered, then subsequent patent holder's attempt will fail.

The information registered in the non-proprietary license is publicly available. Any subsequent patent holder may look at such information before acquiring the patent rights. Thus, we may conclude that the registration system of a non-proprietary right tries to balance the interests of the existing licensee against those of the subsequent assignee or the acquirer of the patent rights.

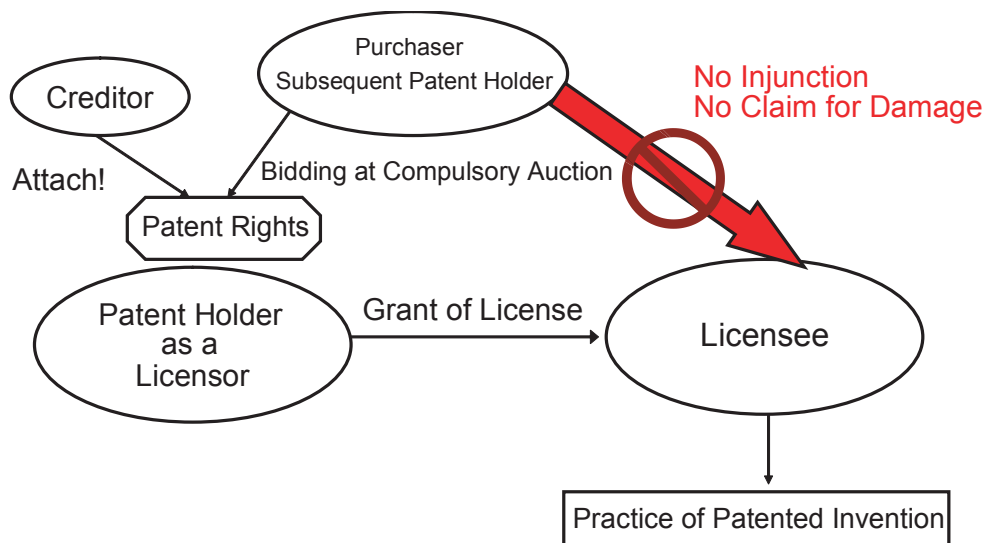
(Fig.11 Patent Rights Assigned to a Third Party)



(Fig.12 Licensor Goes Bankrupt)



(Fig.13 Compulsory Auction of Patent Rights)



## V. AMENDMENT TO THE BANKRUPTCY LAW OF JAPAN IN 2004

How should we estimate the legal effects of the registration of a non-proprietary license? Can we conclude that the registration system provides a solution satisfactory to a non-proprietary licensee? Without evaluating the effects of the bankruptcy law, we cannot correctly assess the impact of the registration of a non-proprietary license. Therefore, let us move on to discuss the effects of the bankruptcy law on the status of a non-proprietary licensee.

### *Concerns of a Licensee under the A. Bankruptcy Law of Japan Prior to Its Amendment of 2004*

1. Cancellation of Bilateral Contracts by a Receiver of a Bankruptcy
  - a. *What is the role of the receiver of a bankruptcy?*

It is needless to say that a receiver of a bankruptcy owes a duty to:

- dispose of the assets of the bankrupt party as soon

as possible;

- execute the outstanding rights of the bankrupt party against debtors; and
- distribute the remaining or collected assets to the creditors of the bankrupt party in a fair manner (Articles 78 through 90 of the Bankruptcy Law of Japan).

What is the major obstacle to the performance of the duties of the receiver? Undoubtedly, it is the ongoing contractual relationships between the bankrupt party and others. If such contractual relationships cannot be terminated, the duty of the receiver cannot be completed until the end of the term of the contract.

- b. *How to deal with the contracts existing between the bankrupt party and a counter-party?* (Fig.14)

Naturally, at the time the bankruptcy procedure commences, there are many outstanding contracts between the bankrupt party and counter-parties. Assume that any and all obligations of the bankrupt party under said contract have been already performed, and that there are unperformed obligations of the counter-party remaining. In this case, the receiver's duty is very simple. The receiver is simply to request

the other party to perform his/her obligations.

Assume that every obligation of the counter-party has been performed, and that there are unperformed obligations of the bankrupt party remaining. In this case, the counter-party is simply to request the receiver to perform the bankrupt party's obligations.

However, assume that there remain outstanding obligations of both the bankrupt party and the counter-party. If neither of the bankrupt party or the counter-party takes any action, the contract just continues, and the rights and obligations of both parties continue to exist. This means that the bankruptcy procedure cannot be closed until the termination of the contract. This result is against the interests of the creditors of the bankrupt party.

**c. The rights of the receiver of the bankrupt party to cancel a bilateral contract provided by the Bankruptcy Law**

In order to solve said problems, the Bankruptcy Law provides the receiver of a bankruptcy with the rights to cancel bilateral contracts outstanding between the bankrupt party and the other parties. The 2004 Amendment to the Bankruptcy Law of Japan did not alter this provision.

Article 53 of the Bankruptcy Law of Japan after its amendment of 2004 reads as follows:

1. If both the bankrupt party and the counter-party have not yet performed provisions of a bilateral contract at the time of commencement of a bankruptcy procedure, the bankruptcy trustee may either cancel the contract or perform obligations of the bankrupt party and demand the counter-party to perform its obligations.
2. In the case of the preceding paragraph, the counter-party may set a reasonable period within which the bankruptcy trustee must provide a definite reply as to whether the trustee will cancel the contract or demand the counter-party to perform its obligations. In such a case, if the bankruptcy trustee fails to provide a definite reply within such a period, the contract shall be deemed to have been cancelled.
3. The provision of preceding paragraph shall apply *mutatis mutandis* to the case where the counter-party or the bankruptcy trustee may make an offer to cancel the contract under the provision of the former part of Article 631 of the Civil Code or may cancel the contract under the provision of the former part of paragraph 1 of Article 642 of that Code.

(Fig. 14 How to Deal with the Contracts between the Bankrupt Party and Others?)

Bankrupt Party	The Other Party	Role of Receiver
No obligation remaining unperformed	Obligation remaining unperformed	Request the other party to perform his/her obligation
Obligation remaining unperformed	No obligation remaining unperformed	Perform the bankrupt party's obligation or pay consideration for damages due to failure to perform obligations within the outstanding assets of the bankrupt party
Obligation remaining unperformed	Obligation remaining unperformed	Terminate the outstanding relationship

2. Why Would the Receiver of a Bankruptcy of the Licensor Seek to Cancel an Existing License Agreement?

We have gone through a general discussion about the cancellation of a bilateral contract by a receiver in bankruptcy. Now, let us move to the discussion of the concerns of a licensee. Why does the cancellation of a license agreement by a receiver concern a licensee?

*a. A patent license agreement can be a bilateral agreement with obligations of both parties remaining unperformed (Fig.15)*

Assume that there is an outstanding patent license agreement, wherein the bankrupt party is the licensor, and the counter-party is the licensee. Imagine the status of both parties at the time when the licensor, who is the patent holder, goes bankrupt. In all likelihood, the licensee continues to be obliged to pay royalties to the licensor. On the other hand, the bankrupt licensor's obligations under the license agreement also remain outstanding. The licensor is obliged to keep refraining from enforcing patent rights against the licensee. This analysis of a license agreement demonstrates that a license agreement can be a bilateral agreement with outstanding obligations remaining on both sides.

*b. Cancellation of a license agreement by a receiver of the licensor's bankruptcy*

Assume that you are the receiver of the licen-

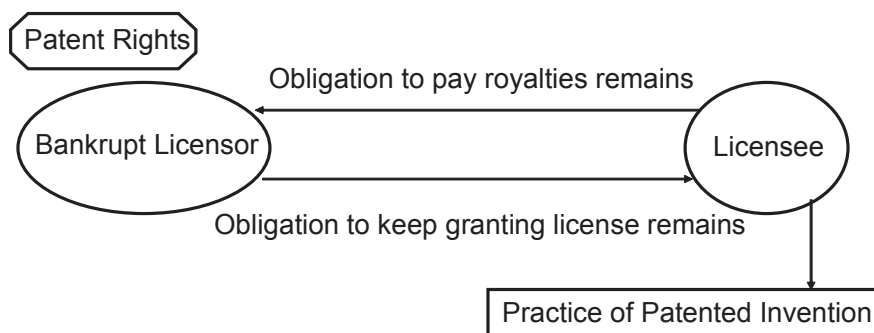
sor's bankruptcy. Why would you want to cancel the outstanding license agreement?

(1) First of all, a receiver would wish to proceed with the bankruptcy procedure as quickly as possible, without agreements remaining effective. It is not surprising that you wish to terminate the license agreement.

(2) Secondly, the receiver would wish to sell the assets of the bankruptcy at the highest price possible. In so doing, the receiver can give greater distribution to the creditors of the bankrupt licensor. In order to achieve this goal, the receiver would wish to remove any burden to which the bankruptcy assets are subject.

Now, the receiver may wish to discuss how to handle the patent rights held by the bankrupt party. The receiver would wish to sell the patent rights at the highest price. Therefore, the receiver may wish to get rid of the license to practice the patented invention. Why? If the license remains, the purchaser of the patent rights will be barred from executing the patent rights against the outstanding licensee. The receiver may wish to cancel the outstanding license agreement, and in this way, the patent rights become released from the burden of license. Then, a potential purchaser of the patent rights may become ready to pay for the patent rights.

(Fig.15 A License Agreement Can Be a Bilateral Agreement with Obligations of Both Parties Remaining Unperformed)



### 3. What Are the Concerns of the Licensee?

As we have already discussed, a registered non-proprietary license can be claimed against a subsequent acquirer of the relevant patent rights. Then, what is the problem? Why is the licensee concerned about the cancellation of the outstanding license agreement by the receiver of the licensor's bankruptcy?

The reason is not so complicated. The legal ground for registration of the license under the Patent Law of Japan is the existence of the license agreement. Assume that the receiver of the licensor's bankruptcy cancels and terminates the license agreement. The ground for the registration of the patent license no longer exists. So, the receiver becomes able to eliminate the registration of the license. Now, the licensee becomes deprived of the power to claim his/her rights against any subsequent acquirer of the patent rights. Undoubtedly, this scenario demonstrates the reason why the licensee would be concerned with the cancellation of the existing license agreement by the receiver of the licensor's bankruptcy.

#### *B. Concerns of the Licensee Resolved by the Amendment to the Bankruptcy Law in 2004, and Concerns Unresolved*

##### 1. Amendment of the Bankruptcy Law of Japan in 2004

The amendment of the Bankruptcy Law of Japan in 2004 has introduced a new provision to the law.

Article 56 of the Bankruptcy Law of Japan as amended in 2004 reads as follows:

1. The provisions of paragraph 1 and paragraph 2 of Article 53 shall not apply to a case wherein the counter-party to the contract, which creates the right of lease and any other rights purporting use and profits, has the registration, record or any other requisites by which it asserts said

rights against any third party as to the said right.

2. In the case provided in the preceding paragraph, the counter-party's right to claim shall become a claim appertaining to the bankruptcy estate.

It is not difficult to grasp the essence of this provision. Assume that there exists an outstanding license agreement between the bankrupt licensor and the licensee, and assume that the license is registered at the Japan Patent Office. Under the new Bankruptcy Law, the receiver has no power to cancel the license agreement because there exists a "registration" of the license. This means that the receiver cannot eliminate the registration of the license. Conclusion: the licensee can claim his/her licensee's rights against the subsequent patent holder even after the receiver disposes of the patent rights previously held by the bankrupt licensor. In order to protect the licensee from the exercise of the patent rights by the subsequent patent holder, no license agreement between them is required. The surviving registration of the patent license eliminates this concern of the licensee.

##### 2. Balancing the Interests of the Licensee and the Receiver or the Subsequent Patent Holder

Article 56 of the amended Bankruptcy Law provides the licensee with considerable bargaining power to negotiate with the receiver of the bankruptcy, or to negotiate with the subsequent patent holder.

Assume that you are the existing licensee. You may negotiate with a subsequent patent holder who purchased the right from the receiver. You would demand that the subsequent patent holder execute a new license agreement with you. Otherwise, the subsequent patent holder may propose that you execute a new license agreement with him/her. In such a case, you are confident that the other party has no power to terminate your licensee's rights until the end of the

term of the original license registered, or until you breach the terms and conditions of the original license registered at the Japan Patent Office. If the original license term is considerably long, and if there is little chance that you breach the license terms, the only realistic way for the subsequent patent holder to gain a right to terminate the license originally granted to you is to execute a new license agreement with you, and to wait until the end of the term of the new license agreement. In the negotiation of the terms and conditions of the new license agreement, you are in a stronger position because you have little to lose even if you and the subsequent patent holder do not ever reach an agreement.

Otherwise, you may negotiate with the receiver of the bankruptcy regarding the sale and purchase of the patent rights previously held by the bankrupt licensor. You can talk with the receiver like this...

“No other party can offer a higher purchase price than the price I will propose to purchase the patent rights, because any other party has to face the burden of my license. There is only one potential purchaser who does not think that my license is burdensome. That person is me, because I am the existing licensee.” Therefore, you have a strong bargaining position in negotiating with the receiver to purchase the patent rights held by the licensor. Once you purchase the patent rights, you no longer have to pay royalties to anybody.

These powers of the existing licensee are against the interest of the receiver of the licensor's bankruptcy or the subsequent patent holder. However, the registration of the patent license is open to public. Any subsequent patent holder had a chance to scrutinize the registration of the license concerning the patent rights which he/she planned to purchase. Because the subsequent patent holder was constructively fully informed, I do not think that this result under the revised Bankruptcy Law is at all unfair.

How about the position of the receiver of the licensor's bankruptcy? The scope of the alternatives the receiver can choose has become narrower because

the receiver has no means to eliminate the registration of the existing license. However, the duty of the receiver is simply to do what is best for creditors of the bankrupt party to the extent permitted by law. Because the law restricts the abilities of the receiver, the receiver becomes liable to no one, even if he/she has no alternative but to sell the patent rights to the existing licensee.

Conclusion: We should admit that the 2004 Amendment to the Bankruptcy Law is making hard efforts to maintain the balance of interests between the receiver of the licensor's bankruptcy, or the subsequent patent holder, and the existing licensee.

### C. *Concerns of the Licensee Remaining after the 2004 Amendment of the Bankruptcy Law*

#### 1. Not All of the Licenses Are Registered

The 2004 Amendment to the Bankruptcy Law expanded the protection of the registered patent licensee. However, the receiver of the licensor's bankruptcy is able to cancel and terminate any existing license agreement as before, if the license provided by the agreement is not registered at the Japan Patent Office. Accordingly, the concerns of the licensee are not resolved by the 2004 Amendment to the Bankruptcy Law, unless the license is registered.

#### 2. Why Are Some of the Licenses Not Registered?

There are many reasons why licenses are not registered. Typical reasons are outlined below.

##### a. *Power balance at the time of the execution of the license agreement*

In some cases, the bargaining power of the licensor is stronger than that of the licensee. Naturally, the licensor refuses to register the license at the Japan Patent Office.

***b. Public disclosure of license not preferred***

In some cases, both parties to the license agreement wish to avoid disclosing the existence of the license agreement, as well as the terms thereof, to the public, because any information of existing patent license can be a clue towards discovery of the business strategy of those parties.

***c. Registration of certain types of license is not realistic***

In some cases, bundles of patented inventions within a broad scope of categories are licensed by one license agreement. The scope of the category is often defined by the field of technology, or by the class of products into which the inventions are implemented. Please note that a registration of a license under the Patent Law of Japan must be made for each patent right concerned. Under the Patent Law of Japan a license cannot be registered without identifying individual patent rights. It would be very cumbersome to itemize every patent falling within the defined category in order for the license to be registered. Accordingly, such a license is not registered in many cases.

Also, such a license covers those inventions which are not yet patented, or for which a patent application has not yet filed. Future patents are also covered by such license agreements. However, until the invention is patented by the Japan Patent Office, there is no way to register the related license. It will be burdensome for both the licensor and the licensee to individually register the license, while monitoring if and when any covered invention is patented.

This type of license is not rare. Especially in the electric or electronics businesses, untold numbers of patented and unpatented inventions are implemented in one product. Naturally, the players in such businesses are obliged to execute license agreements which do not itemize the individual patents included in the license arrangements. Moreover, in the electric or electronics businesses, any player faces difficulties to develop and manufacture a product without practicing other player's patented or unpatented in-

ventions. This reality induces almost all of the players to execute so-called cross-license agreements. The essence of this type of cross-license agreement is not the royalties. What is the primary goal of such cross-license agreements? Assume that you are one of the players of such a business. You may want to develop, manufacture, and merchandise your product without being interfered with by your competitors' patent rights. Your competitors may also come to the same conclusion. Naturally, you and your competitors seek to execute cross-license agreements. Without such cross-license agreements, nobody can operate its business with reasonable costs and labors.

In order to achieve this goal, most of the cross-license agreements executed within the electric or electronics businesses do not itemize the individual patents subject to the license arrangements. Rather, they just describe the scope of the category of the inventions subject to the license. Why? You wish to avoid risk arising out of any and all patents of competitors in a certain business or technological area. So, you need the cross-license agreement to cover all such patents existing now and in the future.

This context shows that the patent licenses established by such cross-license agreements are difficult to register at the Japan Patent Office under the Patent Law of Japan.

## VI. VARIOUS PARTIES, VARIOUS OPINIONS

Let us move to learn the various opinions of various parties concerning the protection of patent license not registered under the Patent Law of Japan. Please assume that the relevant license is based on a license agreement which covers numbers of patented and unpatented inventions, without itemizing individual patents. Typical cross-license agreements are also included.



*An Established Enterprise in the  
A. Electric or Electronics Business  
Seeking Stability*

An established enterprise in the electric or electronics businesses is likely to obtain licenses from not a few other companies, including both established and venture firms. Undoubtedly, such enterprises expect that these licenses can be claimed against subsequent patent holders even after the bankruptcy of the original licensor or an assignment of the patent rights from the original licensor to a third party.

Assume that the relevant license arrangement is a cross-license agreement, and assume also that a party to the cross-license agreement becomes bankrupt, and the receiver assigns the patent rights which were subject to the cross-license agreement to a third party. Now, the patent rights are held by a third party who is not a party to the cross-license agreement. The other party to the cross-license agreement can no longer claim its licensee's rights against this subsequent patent holder. This leads to a sudden increase in costs and labor necessary for the other party to continue to manufacture and merchandize those products which may be in conflict with the patent rights acquired by the subsequent holder.

*B. A Venture Firm and Its Investors*

Assume that a technology venture firm grants a patent license to a large and established company and receives running royalties from such a licensee company. Probably, this license is a non-proprietary license and not registered at the Japan Patent Office under the Patent Law. Then, assume that the financial position of this technology venture firm worsens due to poor royalty income. The poor performance of the venture firm may be caused by unfavorable royalty rate. On the other hand, the difficulties of the venture firm may be caused by the poor marketing efforts of the licensee company. Under these circumstances, the management of the venture firm has to

find a way to give its investors the chance to recover their investments. Several ways are possible.

1. Assignment of Patents and Related Businesses to a Third Party or a Newly-Established Venture Firm (Fig.16)

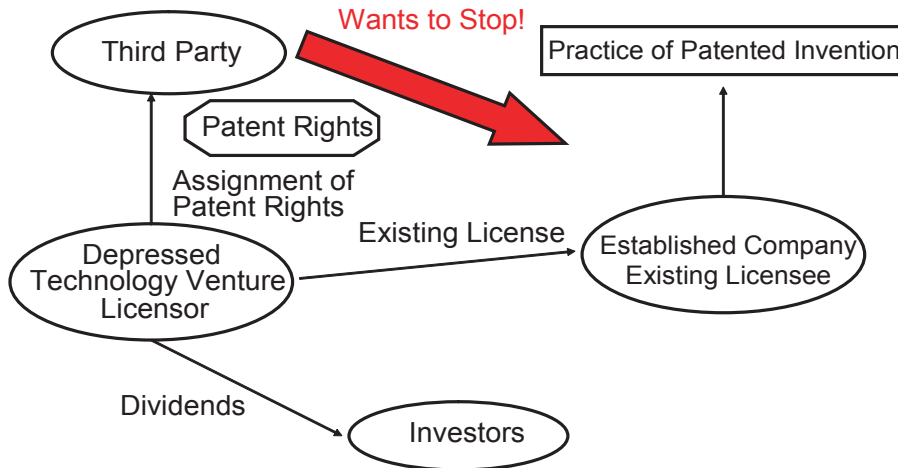
If the venture assigns its patents and related businesses to a third party, the venture can receive the purchase price from the assignee and may distribute the income to its investors. If the assignee is a newly-established venture firm, the investors can have a chance to invest in the new venture firm, as well as to receive dividends in the liquidation of the unsuccessful venture firm. In order for the venture firm to successfully realize such a scenario, the assignee of the patent rights should have the rights to prevent the existing licensee from practicing the patented invention. Why? The assignee or the newly-established venture firm may wish to practice the invention themselves. Or, they may wish to seek a new licensee who will pay a satisfactory amount of royalties. Otherwise, they may wish to gain strong bargaining position in order to amend the terms and conditions of the existing license agreement with the licensee and make them more advantageous to the licensor.

2. Negotiation with the Licensee to Purchase the Patent Rights or the Venture Firm (Fig.17)

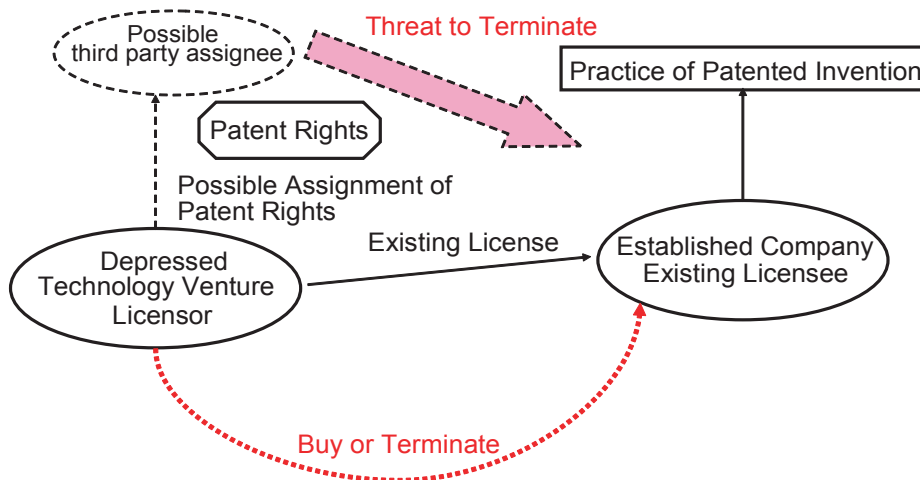
There is another scenario. The venture may wish to request the licensee to purchase the patent rights in question, or all of the business and assets of the venture firm, or all shares of the venture firm. If the licensee purchases the patent rights or the business and assets of the venture firm, the venture firm can distribute dividends to investors while liquidating itself. If the licensee purchases all shares of the venture firm, the investors of the venture firm can also get considerations (cash or shares of the larger company, which they may publicly trade).

How can a venture firm get the bargaining power to negotiate effectively with the licensee compa-

(Fig. 16 Assignment of Patents and Related Businesses to a Third Party or a Newly-Established Venture Firm)



(Fig. 17 Negotiation with the Licensee to Purchase the Patent Rights or the Venture Firm)



ny? The key is the Bankruptcy Law. If the venture firm goes bankrupt, the receiver may terminate the license agreement and transfer the patent rights to a third party, which can be a competitor to the existing licensee. Then, the existing licensee cannot claim its rights against the subsequent patent holder. Accordingly, the threat of bankruptcy of the venture firm constitutes a great amount of bargaining power.

What does this discussion demonstrate? It is advantageous to the technology venture firms and their investors that existing licensees cannot claim their rights against the receiver of the licensor's bankruptcy, or the subsequent patent holder, unless the licenses are registered at the Japan Patent Office under

the Patent Law of Japan.

### C. An Active M&A Player

An active merger and acquisition player may be a stock corporation or a so-called buyout fund. They sometimes focus on the value of intellectual properties held by a venture firm or smaller companies. Undoubtedly, they hope the patents are free from the burden of existing licenses. So, they have interests in common with ventures firms. They are also potential purchasers of deteriorated or depressed technology venture firms.

## VII. REGISTRATION FOR SPECIFIED NON-PROPRIETARY LICENSE

### A. *Establishment of the New Registration System in 2007*

On April 27, 2007, the “Law Amending a Part of the Special Measure Law for Reviving Industrial Vitality” passed at the Diet, and was publicized on May 11, 2007 as Law No. 36. It is easy to imagine that this new system will protect the licensee of a patent license agreement which does not itemize the individual patents included in the license by their registration numbers. Surely, that is the essence of this new system. Let me outline the key concepts of the new registration system established by this law (Articles 58 through 71 of the Special Measure Law for Reviving Industrial Vitality (Law No. 131 of 1999), as so amended).

#### 1. Specified Non-Proprietary License Contract

A “specified non-proprietary license contract” is one of the key concepts of the new law. The new law prepared a registration system to register the non-proprietary licenses given under a “specified non-proprietary license contract.” A “specified non-proprietary license contract” is defined as a patent or utility model license contract satisfying four requirements, itemized below:

##### a. *The First Requirement*

This license must be a non-proprietary license granting a licensee a right to practice a patented invention or a utility model. So, the licensor must be a patent holder, a proprietary licensee of a patent, a utility model right holder, or a proprietary licensee of a utility model. Any license agreement includes a great number of affiliated or related provisions. Typically, a patent license agreement often includes a provision for the license of unpatented inventions, or trade secrets. However, these provisions do not prevent a patent or utility model license agreement

from being deemed a “specified non-proprietary license contract.”

##### b. *The Second Requirement*

Both of the parties to the license agreement must be corporations. If any of the parties to the license contract is an individual or a partnership, such a license does not fall within the category of specified non-proprietary license contracts. According to the Ministry of Economics, Trade and Industry (“METI”), this is because the law was enacted as industry policy (Seiro Hatano & Sentaro Ishikawa, *Re. Registration System Of Specified Non-Proprietary License Under The Law Amending A Part Of The Special Measure Law For Reviving Industrial Vitality*, 860 NBL 18 (2007)). A major part of the Japanese industry depends on the business activities of corporations.

##### c. *The Third Requirement*

A “specified non-proprietary license contract” must be made in “writing.” Moreover, the contract must clearly specify the scope of the relevant license.

##### d. *The Fourth Requirement*

The patents and utility models subject to the license are not identified by their patent numbers or utility model registration numbers. The relevant patent license contract may also include a license of patent or utility model specifying them by their registration number. However, any patent or utility model specified by its number is not protected by this new registration system. Protection of these patents must be made through the traditional registration system under the Patent Law of Japan for each of them.

#### 2. Registry of Specified Non-Proprietary License

The registry of a non-proprietary license under the Patent Law is compiled for each patent right which has an individual patent number. However, the registry of a Specified Non-Proprietary License is expected to be compiled for each individual licensor. The registry will be managed by the Patent Office.

### 3. Items of Registration

Application for registration is to be jointly made by the licensor and the licensee. The registration will contain some information showing the rights of the licensee. Itemization thereof follows.

*a. Class of the License to Be Registered*

Grant of non-proprietary license, assignment of such non-proprietary license, or limitation of disposition of such non-proprietary license.

*b. Identification of the Licensor*

*c. Identification of the Licensee*

*d. The Scope of Patents, Proprietary Patent Licenses, Utility Models, or Proprietary Utility Model Licenses Subject to the Relevant License*

Please note that you can specify certain patent or other rights to be excluded from the registration by identifying their registration numbers.

*e. The Scope of License within Which the Licensee is Granted Rights to Practice the Patented Inventions or the Utility Models.*

*f. The Period of Duration for the Registration of License.*

The term of the registration of license cannot exceed ten years. If the license term is over ten years, you must register the license again after the expiration of the initial ten year license registration.

#### *B. Licensee by the Registration of the Specified Non-proprietary License?*

Now, let us go through the legal effect of the new registration system. To simplify our discussion, we assume that the licensor is a patent holder. Shortly, it is a protection of the licensee against the receiver of the licensor's bankruptcy or the subsequent patent holder. This effect is the same as the effect of ordinary (or, traditional) registration of the non-proprietary patent license under the Patent Law. The receiver of the bankruptcy cannot cancel and terminate the relevant license agreement because the licenses based on said license agreement are regis-

tered. The licensee has the right to claim his/her licensee's rights against the subsequent patent holder. Accordingly, the subsequent patent holder may not request an injunction or compensation for damages due to the practice of the patented invention by the licensee.

#### *C. To Whom and to What Extent the Items of Registration Are Disclosed*

##### 1. Comparison with the Registration System under the Patent Law

Under the traditional registration system for non-proprietary patent license under the Patent Law, any and all registered information is disclosed to the public. So, you can discover any burden of license which may reduce the value of the patents before taking substantial action in order to purchase the patent rights or the patent holders.

Assume that you want to purchase certain patent rights or the company holding such rights. If you start communication with the patent holder, some competitors may notice this. A competitor's awareness may increase the cost of purchase of the rights, or the share or business of the patent holder, or may shorten the time which you have to prepare for the acquisition. So, you want to find out the status of the target patent rights silently. Because any information under the traditional registration system is public, you can do it quickly and silently before starting communication with the patent holder. If you start a negotiation with the patent holder, or start due diligence of the target patents, that involves much labor and cost. Naturally, you wish to learn material burden to the target patents with as little labor and cost as possible. Because any information under the traditional registration system is public, you can act in a cost- and labor-effective way.

Assume that you are a banking corporation lending money to a borrower which is holding a large number of patent rights. If the borrower defaults in repayment of the loan, you will explore assets of the

borrower to attach and exchange to cash through compulsory auction. Because the borrower holds many patent rights, such rights can be candidates for such assets. However, the labor and cost for attachment and compulsory auction are not insignificant. So, you want to avoid attachment of patent rights if they are not likely to be sold at a high price. Naturally, you want to look at the status of the patents held by the borrower in order to ascertain which patents are subject to registered license and which are not. If the borrower notices that you began to appraise the borrower's patents, the borrower may dispose of the patents before you attach them. So, you want to investigate the status of the borrower's patents without being noticed by the borrower. Because any information under the traditional registration system is public, you can do it silently.

Then, what is the outcome if the new Specified Non-Proprietary License Registration is employed?

## 2. Publicly Available Information Is Limited under the Specified Non-Proprietary License Registration

### a. *Items Publicly Available*

Only the purpose of the license, and the identity of the licensor are publicly available. Identity of the licensee, the scope of the patents subject to license, and the scope of license for the practice of inventions are not publicly available. This means that a silent assessment of patent rights is impossible for the potential purchasers of patents or creditors of the patent holder.

### b. *Items Available to Limited Parties Concerned*

Some of the information not publicly disclosed is available only to limited parties concerned upon their request to the Japan Patent Office. These limited parties concerned may get information on the identity of the licensor, the identity of the licensee, the period of duration of the registration of the license, the date of registration, and the itemization of patents expressly excluded from the relevant reg-

istration. However, they cannot get information on the scope of patents subject to license. The scope of license is also not available. I believe that the scope of license is essential to assess the value of patents subject to the licenses. Disclosure of registration of a license to creditors or pledge right holders without this information makes little sense.

The next question is who falls within the category of the limited parties concerned.

(1) Those who have acquired the patents held by a registered licensor will be able to get such information. Note that they cannot get information when they are just considering whether they should acquire such patents or not.

(2) The creditors of the registered licensor will be able to get such information only after they have made attachment or provisional attachment of the patents belonging to the registered licensor. Note that they cannot get information when they are assessing whether they should go for attachment or not.

(3) Those who have pledge rights on the relevant patent rights.

(4) Those who have the right to manage and dispose of the relevant patent rights, typically, a receiver of the licensor's bankruptcy.

### c. *Who can Obtain All the Information?*

The registrants, those who have acquired the patents subject to the registration, and the receiver of the licensor's bankruptcy may get all the registered information upon their request to the Patent Office.

## D. *Problems Caused by the New Registration System*

The new registration system has given the licensees of a patent license agreement which does not identify individual patents strong panoply to claim their rights against receivers in bankruptcy and subsequent patent holders. However, this system seems to have failed to balance between the rights of licens-

ees and those of receivers or subsequent patent holders. The problems are described below.

### 1. Silent Assessment Is Denied

Assume that you wish to acquire the patent rights subject to the Specified Non-Proprietary License Registration, or to acquire the company holding such patent rights. You cannot make silent assessment to find which license the patent rights are subject to. Undoubtedly, if you start due diligence after contracting a non-disclosure agreement with the target company, you will be able to get satisfactory information. However, every M&A and finance lawyer knows how important the silent assessment prior to due diligence is. Substantial denial of silent assessment to the patents may stifle active trade of patents or shares of patent holders.

### 2. Disadvantage to One Party of a Cross-license Agreement (Fig. 18)

Assume that corporation-1 and corporation-2 are competing with each other in the home-use printer market. Naturally, they have concluded a cross-license agreement concerning their patented inventions. These licenses may be registered in the Specified Non-Proprietary License Registry.

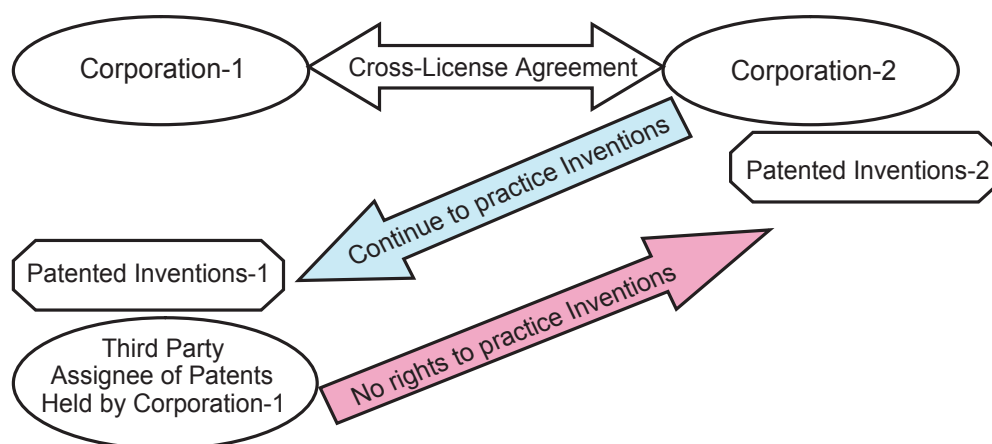
Now, assume that corporation-1 has decided to withdraw from the printer market, and to sell its

printer business as well as related patent rights to a third party. What is the resultant relationship between the third party acquirer and corporation-2? Corporation-2 may claim its licensee's rights against the third party acquirer, while refusing the third party acquirer's request to execute a new cross-license agreement. The third party acquirer would consider this extraordinarily unfair.

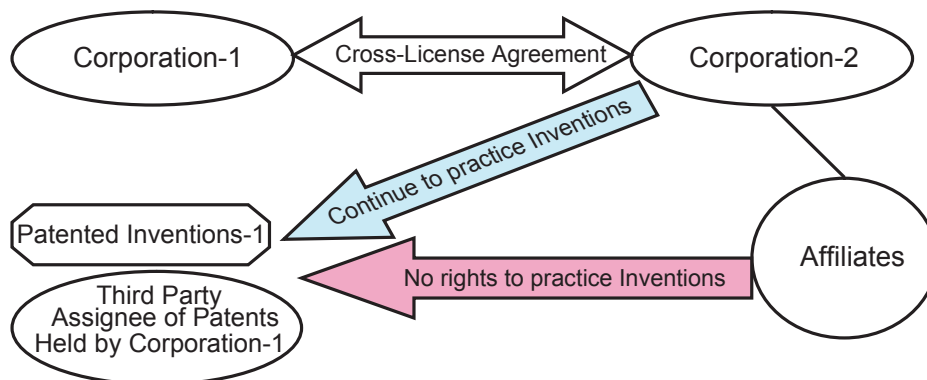
### 3. Limited Benefit to Subsidiaries of and Companies Affiliated to a Cross-License Party (Fig. 19)

In many of the cross-license agreements in the electric or electronic businesses, subsidiaries of and companies affiliated to a party are also granted rights to practice the patented and unpatented inventions of the other party. Because reorganizations within any group of companies are carried out from time to time, a cross-license agreement does not identify such beneficiary subsidiaries and affiliates by their names. Rather, the scope of such beneficiary companies is often defined by the share of their voting rights held by the party to the cross license agreement. Accordingly, these beneficiary companies will not be registered as licensees in the new Specified Non-proprietary License Registry. So the benefit of the new registration system will be limited.

(Fig.18 Disadvantage to One Party of a Cross-License Agreement)



(Fig.19 Limited Benefit to Subsidiaries of and Companies Affiliated to a Cross-License Party)



#### 4. Barrier to Active Trade of Patents

Undoubtedly, these problems will constitute a barrier to active trade of patents or M&A of patent holder companies.

### VIII. CONCLUSION

Balancing the interests of a patent licensee and those of a subsequent patent holder or a receiver of the patent holder's bankruptcy is extremely difficult.

The new Specified Non-proprietary License Registration has introduced a strong protection to the licensees of certain types of license agreements such as typical cross-license agreements. However, I believe that this new registration system failed to achieve a good balance of interests. Various classes of governmental agencies, lawyers, and industry players are responsible for this. Among all, the Ministry of Economics, Trade and Industry, responsible for proposing this law, has failed to listen to opinions from financial institutions, investors, and venture firms. In fact, the Ministry has even failed to communicate with the players. These players have also failed to study the impact of the new license registration system, and virtually no opinions have been publicized from these player groups, other than those of myself and my colleagues.

In my opinion, it would be acceptable to protect licensee of cross-license agreements against the subsequent patent holders. However, the counter-parties should also be given the benefit of cross-license. Moreover, any party, including creditors, banking institutions, investors, and potential acquirers should be given the opportunity to conduct silent assessment of the status of any patent rights which may be subject to certain licenses.

Licensees should be given the right to claim their rights to continue practicing patented inventions against subsequent patent holders who merely claim damages against existing licensees without actively practicing or licensing patents. We have no reason to protect patent trolls. However, a subsequent patent holder who will actively practice or license patents should be protected against submarine like license. They should be given a chance to assess the patents in advance.

We, as current and future legal professionals, are responsible for designing a balanced legal system, as well as taking significant steps to rectify the imbalances existing in the current legal system.

(Shinto TERAMOTO)