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JAPAN M&A

Second Edition

Contributing Editor
Tatsuya Morita

LEXOLOGY
Getting the Deal Through

JAPAN M&A

Practice Guide

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Getting the Deal Through

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Key Intellectual Property Issues in M&A Transactions

Takashi Hirose[1]

Introduction[2]

Japan is a scientific and technological nation, with one of the most important markets and the third-largest GDP in the world. The number of annual patent prosecutions (including international patent applications) in Japan is about 288,000,[3] which is the third-largest in the world. Japan is home to many global companies with highly technological and innovative skills and capabilities. Japan also has a suitable business and legal environment for companies; for instance, there is a very low crime rate, a highly educated workforce and a reliable judicial system, especially regarding intellectual property-related cases. The Tokyo and Osaka District Courts have specialised divisions for intellectual property (IP) and Tokyo is also home to the Intellectual Property High Court. The average number of months needed for courts to resolve IP-related cases at the first instance is only around 12 to 15 months.[4]

IP and intellectual property rights (IPRs) are important assets that are key to Japanese companies' core value and the keys for the success of these companies in business. The important value of IPRs is the ability to exploit them economically. These include defensive abilities, for instance, preventing competitors from using a patented invention and making infringers pay

1 Takashi Hirose is an attorney at law (Japan and California) and a partner at Oh-Ebashi LPC & Partners (Tokyo office).

2 This chapter explains only some basic characteristics of the Japanese intellectual property system and some important issues in the M&A transaction context. It is not an exhaustive summary. In addition, this chapter purely reflects the personal opinions of the author, and does not represent the views of Oh-Ebashi LPC & Partners.

3 Japan Patent Office Annual Report, www.jpo.go.jp/resources/report/nenji/2021/document/index/honpen0101.pdf.

4 Intellectual Property High Court, www.ip.courts.go.jp/vc-files/ip/2021/chisai.pdf.

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damages. In addition, positive effects regarding external communication,[5] for instance, branding corporate products and services, are also included. Legal due diligence on IP is therefore a vital part of any preparation for an M&A transaction. One of the keys for the success of M&A transactions is to spot IPR issues properly and to take reasonable measures to deal with the issues. It is especially important for a buyer to ensure that key target company IP used before the M&A transaction will be continuously available to the buyer side (the target company or target business).[6]

Collecting IP-related information of the target company before an M&A transaction in light of the characteristics of the Japanese IP system is therefore important. Examples of information to be collected include:[7] [8]

- lists of important IPRs owned by the target company;[9]
- lists of IP licences granted to the target company[10] (not only from third parties but also from group companies of the target company), and licence agreements thereof;
- lists of IP licences the target company grants to third parties (including group companies of the target company), and licence agreements thereof;
- other IP-related agreements (including joint research and development agreements) other than licence agreements;
- IP-related agreements (including software licence agreements), materials on software used by the target company, how they are developed, third parties involved in the development or owning rights in the software (other than licensor, if any);
- material on the overview of the department that deals with and manages IP matters;
- internal rules of the target company to deal with or manage IP (including but not limited to internal rules on employee inventions), material on how the rules are implemented, etc; and

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5 In June,2021, the amended Corporate Governance Code, a guideline made by Tokyo Stock Exchange and Financial Services Agency for listed companies, includes items related to disclosure of IP investment strategy by listed companies. In addition, in response to the said amendment, in January 2022, so called as the IP and Intangible Asset Governance Guideline was disclosed, in which the importance of disclosure of IP strategy with logical explanations and story lines is emphasised.

6 In M&A transactions, in many cases the target is a company itself; however, in some cases the target is not a company itself but rather a part of the business of a company. In this chapter, 'target company' is used to also include cases where the target is part of the business of a company.

7 This is not an exhaustive list.

8 M&A transactions almost always require legal due diligence including IP due diligence. The buyer learns about the (potential) strong and weak points and related issues of the relevant IPRs. It is usual that the parties to the M&A transaction sign non-disclosure agreements (NDAs) regarding restrictions on the use of such confidential information. However, the protection given by the NDA is not perfect. If the M&A deal fails, the directors or employees of the potential buyer who are involved in the deal process still know the said points and issues. Carefully structuring the contents of NDAs, limiting the scope of persons who can receive the core confidential information and retaining a right to audit, etc are important, but this is still not perfect protection.

9 It is better to include information on any encumbrances including pledges and licences granted to third parties, etc.

10 It is better to include information on whether there is any non-performance of the obligations in the licence agreement by the target company that would lead to losing the licence granted.

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- material on IP-related disputes (including potential disputes) in which the target company or the IP used by the target company is involved (in addition, it is better to include information on any grounds for invalidation[11] of the important IP).

Intellectual property rights

Identification of IPRs

As stated, it is very important for a buyer to ensure that important IP of the target company used before the M&A transaction can be continuously available to the buyer after the transaction. Identification of the IPRs relevant for the intended M&A transaction, as well as analysis, description and appropriate listing thereof, are the important starting points of the deal process and essential for the success of the transaction. Thus the buyer must try to obtain from the seller comprehensive lists of important IPRs, including licences relevant to the M&A transaction. To check and supplement the lists, the buyer can check registered information at the Japan Patent Office (JPO) for patent, utility model, trademark and design rights (together, industrial property rights). However, there are certain limitations to this.[12] In addition, with regards to unregistered IPRs, such as copyrights, it is more difficult to check the comprehensiveness of the lists provided by the seller side based on public information. Therefore, in addition to appropriate efforts to collect information from the seller, it is important, for instance, to establish representation and warranty clauses stating that the target company legally and validly owns or is granted the IPRs that it uses or utilises to conduct its current business and that the said IPRs do not have any encumbrances that have an adverse effect on or inhibit the use of such IPRs.[13]

Points to note in schemes of M&A transactions

As stated under 'Licence', the schemes of M&A transactions mainly include share acquisition, comprehensive succession (eg,merger, company split) or a specific succession scheme (eg, business transfer). However, regardless of the schemes intended, identification of the relevant important IPRs is vital.

In a share acquisition, ownership of IPRs does not change directly, but checking the following points is important. First, the transaction may have an impact on licences granted to the target company since licence agreements often contain a change of control clause that might lead to

11 It is difficult to thoroughly find and evaluate issues regarding the grounds for invalidation of the important IP because of the limitation of time and other resources in legal due diligence. Thus checking the grounds for invalidation thoroughly is often excluded from the scope of due diligence. Consequently, for instance, a proper arrangement of representation and warranties is important.

12 Registers of industrial property rights include information on the name of the owner of an industrial property, whether assignment was made, whether an exclusive licence (*senyo jissiken* or *shiyoken*) is granted to a third party, and whether a registered pledge is established on an industrial property right. However, for instance, it should be noted that a non-exclusive licence is not registered.

13 There might be some cases where the compensation is denied or restricted if the buyer actually knows facts contrary to the contents of the representation and warranty clause or does not know such facts because of gross negligence (see Tokyo District Court Judgment 17 January 2006 (Heisei 18) Hanrei Jiho 1920 p136). In addition, it is important to include a clause that states the effects of the breach of the representation and warranty clauses, for instance, the buyer's right to seek indemnification. These would also apply to the other representation and warranty clauses explained in this chapter.

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termination of such licence agreements. Second, some of the relevant important IPRs may not be owned by the target company (but by a group company of the seller or third parties outside the group). In such cases, the buyer would need an arrangement to sell (transfer) the said IPRs to the buyer or to secure a licence (the latter option might be more feasible). Third, the seller may want to keep certain IPRs for continued use.[14]

In a scheme using comprehensive succession, in principle, IPRs are automatically transferred without any individual succession procedures.[15] However, the same issues stated in the share acquisition part also apply.

In a scheme using a specific succession scheme, the assets, liabilities and agreements that the parties agree to transfer are transferred individually. The buyer must ensure that the necessary IPRs are properly identified and allocated.[16] In addition, the buyer has to make sure that the counterparties agree that the said agreements are transferred properly.[17] The second and third points addressed above also apply.

Registered IPRs

As stated, the buyer can find registered information regarding industrial property rights in the JPO IP register[18] (such as ownership of the right and change of the ownership, etc), including patent, utility model, trademark and design rights.[19] [20] However, it should be noted that there are certain limitations on the information registered at the JPO. For instance, with regard to licences, registrations of patents, utility models, trademarks and designs only contain information on

14 If the target company owns an IPR for which the seller or a group company has been granted a licence, there might be some cases where the seller wants to keep the licence.

15 Transfers of industrial property rights have to be registered at the JPO to be effective (Patent Act article 98(1)(i)).For the transfer of the IPRs to take effect under a comprehensive succession scheme (merger, company split), registration at the JPO is not required. Nonetheless, the fact of the succession has to be reported to the Director General of the JPO without delay (Patent Act article 98(2)).

16 Transfers of industrial property rights have to be registered at the JPO to make them take effect (Patent Act article 98(1)(i)).

17 Obtaining the consent as a condition precedent or as a covenant of the seller is a measure worth considering, depending on the importance of the agreements identified.

18 There is a way to request the register information online.

19 Patents are governed by the Patent Act. Utility models are governed by the Utility Model Act. Trademarks are governed by the Trademark Act. Designs are governed by the Design Act.

20 In addition, through the J-PlatPat system, it is possible to check the contents of gazettes for patents, utility models, trademarks and designs to see the scope and contents of the industrial property rights. It is also possible to check ownership, existence of exclusive licences and pledges. There is a time lag for a change of ownership to be reflected in the register, although since May 2019 the functions of J-PlatPat have improved. In addition, to see detailed information on exclusive licences and pledges, the relevant register information still has to be checked.

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exclusive licences (*senyo jissiken* or *shiyoken*).[21] Non-exclusive licences[22] [23] are not registered at each register. In addition, though the registration of a pledge is required for it to take effect,[24] the pledge is not always properly registered.

Therefore it is important to collect information from the target company on whether proper registrations have been made and whether there are any encumbrances. Proper arrangements should be made for conditions precedent, covenants, and/or representation and warranty clauses to deal with registration and encumbrance issues (including, but not limited to, pledges[25] and licences) that may have an adverse effect on or inhibit the use of IPRs.

In addition to the core IPRs mentioned above, checking the company name as well as domain names is also important:

- Domain names are not considered traditional IPRs, but they can be significant in relation to branding, for instance – domain name registration can be checked using a Whois search.
- Company name registration is a requirement to establish a company – company name registrations can be checked online through the Registry Information service. The scope of protection provided by a trademark right is different from that of a company name (in principle, the latter is limited).

Unregistered IPRs

Copyright

It is more difficult to identify and inventory important copyrights[26] that the target company actually owns or utilises. Under the principle of the creator doctrine, the copyright and moral right of an author vest automatically in the author who creates a work.[27] Unlike industrial property rights, no registration is required for copyrights and transferring copyrights. It is true that a registration system for copyrights is available (for instance, registration of transferring copyright and registration of establishment of a pledge are regarded as a requirement for a transferee (or a pledgee) to assert its rights against third parties).[28] However, the items within the scope of the

21 For instance, an exclusive licence (senyo jissiken or shiyoken) occurs on permission of the patentee; however, it does not take effect until it is registered at the JPO. On the other hand, registration is not required for a non-exclusive licence to take effect.

22 Before April 2012, non-exclusive licences for patent rights were registrable, though the registration was not a requirement for the non-exclusive licence to take effect but it was a requirement for duly asserting the right against third parties. On or after 1 April 2012, the system where a non-exclusive licensee can duly assert, without registration, its right against third parties was introduced (for patent, utility model and design rights).

23 A non-exclusive licence includes (as a contractual arrangement) monopolistic non-exclusive licence and non-monopolistic non-exclusive licence.

24 For instance, Patent Act article 98(1)(iii).

25 This is because, if a pledge is established on an important IPR and the obligor defaults on a debt, the said IPR can be taken by the pledgee.

26 For computer programs and licensing issues see 'Licence' section and 'Software and computer programs' section.

27 Important exceptions are work for hire and ownership of cinematographic works.

28 Copyright Act article 77(i)(ii).

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registration systems are limited[29] and the registration system is not widely used. Thus identifying the owner of copyrights, checking the change history for ownership and checking the existence of encumbrances are not easy.[30] In addition, if a work is created cooperatively by multiple people, it makes issues more complicated.[31] Thus, efforts to carefully collect information from the target company or the seller are important.

Other IP

Trade secrets[32] and shared data with limited access under the Unfair Competition Prevention Act (UCPA) are also considered important.[33] They are not registered at a public office. In addition, there are lots of cases where the target companies do not develop lists thereof internally to manage them. Thus efforts to carefully collect information from the target company or the seller are important.

Trade secrets

As one of the important requirements, a trade secret must be kept secret. Generally speaking, it is not easy to satisfy this requirement. It is not sufficient that the owner of the information in issue recognises that it is secret. Instead, it is required that employees or customers easily recognise the owner's intention to keep the information in issue confidential by clearly presenting such intention through an economically reasonable measure with respect to confidential compliance, depending on the specific situation. Thus it is important to collect information on how trade secrets are managed in the target company.

Shared data with limited access

In 2019, in order to protect and use big data, a new amendment to the UCPA was passed that makes shared data with limited access protected under the UCPA. The term 'shared data with limited access' as used in the UCPA (article 2(7)) means technical or business information that is accumulated in a reasonable amount by electronic or magnetic means as information provided

29 For instance, registration of the true name (Copyright Act article 75); registration of the date of first publication, etc (Copyright Act article 76); registration of the date of creation (Copyright Act article 76-2); registration of copyright (Copyright Act article 77); procedures for registration (article 78); exceptional provision for the registration of program works (article 78-2); registration of the right of publication (Copyright Act article 88).

30 On or after 1 October 2020, a non-exclusive licensee of copyright is able to assert his or her non-exclusive licence against a third party without any registration (Copyright Act article 63-2).

31 A person who creates an original work need not to be a single person. Multiple people can express their individualities to create a single work. However, the author should be a person who makes an original expression only. Identifying the author is not necessarily easy. In addition, with regard to joint works, many restrictions are placed on each owner of the copyright for the joint work, for instance, transferring one's share, granting licences and exercising the copyright need the consent of the other joint owners.

32 The term 'trade secret' as used in the UCPA means technical or business information useful for business activities, such as manufacturing or marketing methods, that are kept secret and that are not publicly known.

33 Under the UCPA (ie, article 2 (i)(ii)(iii)), use of an indication of goods and the form of goods can also be protected under certain circumstances.

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to specific persons on a regular basis and that is managed (excluding information that is kept secret).[34] Since this system was introduced recently, there may be many cases where the target companies do not manage such data systematically or develop the relevant lists.

The buyer has to rely on the information for unregistered IPRs from the target company and it is important to consider,for instance, effectively establishing representation and warranty clauses in an M&A agreement.

Licence

Types of licence

Industrial property rights

With regards to Industrial property rights, under the related laws, the types of licence are divided mainly into exclusive licence (*senyo jissiken)*[35] and non-exclusive licence (*tsujo jissiken).*[36] A non-exclusive licence is, as a contractual arrangement, divided mainly into monopolistic non-exclusive licence[37] (*dokusenteki tsujo jissiken*) and non-monopolistic non-exclusive licence (*hi dokusenteki tsujo jissiken*).

Registration is required for an exclusive licence to take effect. Once an exclusive licence is established, for instance, even the patentee is not allowed to work the patented invention. Considering these points, exclusive licences are not widely used. In addition, an exclusive licensee (*senyo jissikenjya*) has the right to seek an injunction and damages, within the scope of the licence agreement, in its own name with respect to an infringement by an unauthorised third party.

For a non-exclusive licence to be established, registration is not required.[38] A non-monopolistic non-exclusive licensee does not have the right to seek an injunction or damages in its own name. A monopolistic non-exclusive licensees is considered to have the right to seek damages in its own name; however, whether it has the right to seek an injunction is not necessarily clear.[39]

34 Some scholars think that information kept secret should not be excluded from the information protected under the UCPA and that there might be some cases where the same information is protected as a trade secret and shared data with limited access (Ono & Matsumura (2020), *Shin Fusei kyoso boushi ho gaisetsu* 3rd edition volume 2, Seirin shoin 2020 pp11–13).

35 For trademark licence, it is called *senyo shiyoken*.

36 For trademark licence, it is called *tsujo shiyoken*.

37 The licensee is entitled to a contractual exclusive right to exploit the IP. In addition, a monopolistic non-exclusive licence is, as a contractual arrangement, divided into cases where the licensor itself is allowed to use the IP and cases where even the licensor itself is not allowed to do so. Thus, it is important to check whether the licensor itself is prohibited in its use of the IP in licence agreements.

38 Before April 2012, non-exclusive licences for patent rights were registrable, though the registration was not a requirement for the non-exclusive licence to take effect but a requirement for duly asserting it against third parties. On or after 1 April 2012, the system where a non-exclusive licensee can duly assert, without registration, its right against third parties was introduced (for patent, utility model and design rights). On the other hand, with regards to trademark rights, a non-exclusive licence is still required to be registered to duly assert it against third parties.

39 See footnote 42.

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Copyrights[40]

The Copyright Act provides only for non-exclusive licences.[41] Thus variations in the characteristics of licences are provided by contractual arrangements. Whether a non-exclusive licensee has the right to seek an injunction, damages, or both can be considered the same as in an industrial property right licence.[42]

Issues related to the scheme of M&A transactions including change of control and similar issues

It is necessary to check whether there are any matters that have an adverse effect on the continuity of the use of the licensed IP.[43] One of the important points when checking licence agreements relating to the target company is to see whether the licences are properly succeeded (the licences granted are continuously available) through the M&A transaction. Whether and how the licences are properly succeeded depends on the type of scheme of the M&A transaction.

Buyer side's acquisition of shares issued by target company (share acquisition)[44]

In principle, theoretically, consents from licensors are not required to maintain licences. This is because the legal character of the target company does not change even after the M&A transaction, so the licensee does not change. However, it is not unusual for licence agreements to include a clause that allows licensors to terminate their licence agreement when a substantial change occurs in the controlling power of the licensee, for instance, a substantial change to a licensee's shareholders or officers[45] (change of control clause – COC clause). If a licence agreement that can be terminated based on a COC clause is essential to the target company, the

40 The UCPA does not provide any type of licence regarding trade secrets. In addition, there is no registration system at a public office. The contents of trade secret license depend on a contractual arrangement between parties.

41 There is an exception. The owner of print rights has the exclusive right to reproduce the unaltered original work (Copyright Act article 80(1)).

42 There are several court cases that admit the possibility that monopolistic non-exclusive licensees are entitled to seek injunctions by using the subrogation right of oblige under the Civil Code article 423 (for patent rights, see Tokyo District Court 31 August 1965 (Syowa 40) Hanreitaimuzu 185 gou p209); for trademark rights, see Osaka High Court 10 July 2002 (heisei 14) (heisei 13 (ne) 23 gou); for copyright, see Tokyo District Court 31 January 2002 (Heisei 14) (hanrei jiho 1818 gou p165) and Tokyo District Court 29 September 2016 (Heisei 28).9.29 (Heisei 27 (wa) 482 gou)). However, among practitioners and scholars, there is still no common view regarding whether and under what conditions monopolistic non-exclusive licensees are entitled to seek an injunction. (Matsuda, S (2020), Licence Keiyaku Ho (*The Laws of Licence Agreements and Related Transactions*), Yuhaikaku.p74).

43 For instance, it is important to check whether there is any default of the obligation owed by a licensee (the target company) that could lead to losing the licence.

44 This includes purchasing issued shares of the target company. In addition, this can theoretically include, for instance, a share exchange scheme where a procedure for corporate reorganisation stipulated in the Company Act is used to obtain issued shares of the target company and make the target company a wholly owned subsidiary.

45 This often includes the occurrence of corporate reorganisations under the Companies Act, including mergers and company splits, etc.

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purpose of the M&A transaction cannot be achieved without the licence. Then, for instance, one of the measures to be considered is to cause the seller to obtain the consent of the licensor as a condition precedent to closing the M&A transaction. If the licence agreement is important (but not essential) to the target company and certain negative effects are expected on the business of the target company, one of the measures to be considered is to have the seller owe the obligation to obtain the consent of the licensor in issue as a covenant.[46]

In relation, or similar, to the said COC clause issue, the following are some circumstances where checking the continuous availability of licences is important:

1. If an important licence is granted by a group company of the target company or the seller, then it is necessary to check whether it is possible to make an arrangement[47] wherein the target company is granted the licence continuously.[48]
2. If the licensor of an important licence is a pure third party that is not a group company of the target company and the licence is granted to a group company of the target company and the reason why the target company is entitled to use the IP related to the licence is because the target company is under the umbrella of the group company, it is necessary to check whether it is possible to make an arrangement wherein the target company is granted the licence continuously. Compared with (1), there is often more difficultly in achieving such arrangement.[49]

It is also useful to consider the measures outlined in the section discussing the COC clause issue.

Comprehensive succession scheme

The effect of a merger scheme and company split scheme is that, in principle, all or part of the assets, rights and obligations of the target company (or the target business) are comprehensively and automatically transferred. Thus, in principle, consents from the licensors are not required to transfer the licences. However, if a licence agreement includes a COC clause, it is useful to consider the measures stated above in the section on share acquisition.

With regards to patent licences, the Patent Act article 77(3) states 'an exclusive licence may be transferred only where the business involving the working of the relevant invention is also transferred' or 'where the transfer occurs as a result of general succession'. The Patent Act article 94(1) also states that 'a non-exclusive licence may be transferred only where the business involving the working of the relevant invention is also transferred' or 'where the transfer occurs as a result of general succession'.[50] It is considered that the circumstances described in these

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46 In addition, if the licence in issue is an important source of revenue and the licence is terminated because of the M&A transaction, the buyer could also consider using the arrangement to decrease the amount of consideration for the M&A transaction.

47 Transferring the IP licensed from the group company to the target is another measure worth considering. However, in general, a licensing arrangement might be more capable of being realised.

48 One of the important factors is whether there is any inconvenience caused by the fact that the IP regarding which the licence is granted is expected to be used by a company outside the group.

49 Especially cases where the said group company is granted a licence based on a cross-licence arrangement or where the buyer is a major competitor of the licensor of the licence in issue.

50 Design Act article 27(4) and Utility Model Act article 18(3) state that Patent Act article 77(3) applies mutatis mutandis to exclusive licences. In addition, Design Act article 34(1) and Utility Model Act

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two articles includes merger schemes and company split schemes. However, whether these articles are compulsory is not necessarily clear[51] and such issue is debated among scholars and practitioners. Thus, from the buyer's viewpoint, it is safer to consider taking the measures described in 'Buyer side's acquisition of shares' on the premise that these articles are not compulsory and could be displaced by a mutual agreement (ie, a COC clause could terminate the licence agreement even under a merger or company split scheme). In addition, considering the issues around checking the continuous availability of licences outlined in (1) and (2) above is also important.

Specific succession scheme

During a business transfer scheme, specific assets, liabilities and agreements, etc of the target company are identified and transferred individually. Thus, in principle, consent from the licensors is required to transfer the licences. However, a business transfer scheme is considered to meet the requirement of 'where the business involving the working of the relevant invention is also transferred' (Patent Act articles 77(3) and 94(1)).[52]

Nonetheless, as stated above, from the buyer's viewpoint it is safer to consider taking measures on the premise that a COC clause could terminate the licence agreement even under a business transfer scheme.

Perfection of non-exclusive licence without registration

With regards to patents, utility models, designs and trademarks, for an exclusive licence to take effect registration is required, which enables the exclusive licensee to duly assert its rights against a third party.

On the other hand, with regards to patents, utility models and designs, a non-exclusive licensee is able to duly assert its non-exclusive licence against third parties (including the new owner of an IPR) without registration. In addition, on or after 1 October 2020, without any registration, copyright licensees[53] are now able to duly assert rights against any third party who obtains

article 24(1) have the same rule as Patent Act article 94(1). However, the Trademark Act does not apply Patent Act article 77(3) to exclusive licences. In addition, Trademark Act article 31(3) does not have the exact same rule as Patent Act article 94(1). In other words, under the Trademark Act, in principle, a trademark licence may be transferred where the consent of the holder of a trademark right is obtained or where the transfer falls under general succession (for exclusive licence, see Trademark Act article 30(3), for non-exclusive licence, see Trademark Act article 31(3)). 'General succession' is basically considered to include merger schemes and company split schemes. In addition, the Copyright Act does not state the exception on transferring licences, such as 'where business . . . is transferred'. In principle, the consent from the licensor or general succession (this includes merger schemes and company split schemes) is required to transfer the licence for a copyrighted work.

51 Nakayama, N and Koizumi, N (Eds) (2017), *Shin Chukai Tokkyo Ho* 2nd edition volume 2, Seirinshoin. p1455.

52 The same rule applies to utility model and design. However, the rule does not apply to trademark or copyright. A trademark licence may be transferred only where the consent of the holder of such trademark right is obtained or where the transfer falls under general succession (Trademark Act article 30(3) and 31(3)). Business transfer does not constitute general succession. Further, in order to transfer a licence for a copyrighted work, the consent of the licensor or general succession is necessary too.

53 In principle, the Copyright Act does not provide types of licences.

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copyrights from the owner.[54] [55] However, a non-exclusive licensee of a trademark is required to register it to duly assert its rights against third parties.

When checking the existence of encumbrances on IPRs to be transferred by an M&A transaction, the buyer should consider the points outlined above.[56]

Software and computer programs

Software and computer programs sometimes act not only as an important lifeline for the target company to continue its business but also as an important source of revenue. Hence understanding protection under Japanese law and the relevant issues is important for the success of the M&A transaction.

Like other IPRs, it is important to check, for instance, whether there is any issue of ownership of the rights to software and computer programs, as well as the continuity of the licence granted, infringement of third parties' rights and other encumbrances that would have an adverse effect on the use of such IPRs and to consider measures including proper establishment of representations and warranties.[57]

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54 Copyright Act article 63-2. In addition, this amendment is applicable to licence agreements on copyright executed before 1 October 2020.

55 Under the Bankruptcy Act (*Hasanho*), if a licensor becomes insolvent (hasan), a bankruptcy trustee(hasankanzainin) appointed by the court can choose whether to cancel the licence agreement if the licensee does not meet the requirements for duly asserting its right against third parties (Bankruptcy Act articles 53(1) and 56(1)). On or after 1 October 2020 (because of the amendment to the Copyright Act on the perfection system), if the target company is a licensee of a copyright and the licensor become insolvent, the bankruptcy trustee cannot cancel the licence agreement just because proceedings for bankruptcy of the licensor have been initiated. The same rule has been applicable to non-exclusive licences for patent, utility model and design rights since the perfection system for non-exclusive licences was introduced for them.

56 In cases when an asset transfer scheme is used and the buyer obtains an IPR with an encumbrance of a non-exclusive licence to a third party (ie, the target company is the original licensor), which can be duly asserted against the new owner (ie, the buyer) with regards to whether and to what extent the licence agreement itself between the original licensor (the target company) and the licensee (the said third party) is succeeded by the new owner (the buyer), scholars have yet to reach a consensus. (Nakayama, N and Koizumi, N (Eds) (2017) op cit p1607) Thus, a new agreement between the original licensor, the licensee and the buyer on whether and how the licence agreement is transferred is necessary to avoid legal problems. This issue also arises when, after an M&A transaction, the buyer becomes the owner of the target company, which is a non-exclusive licensee who can duly assert its rights against third parties, and after that the relevant IPR is transferred from the original licensor to a new owner of the IPR, it is better for the buyer to seek a new agreement between the original licensor, the new owner and the target company to avoid the said legal problem.

57 If the software in issue is an essential asset of the target company (for instance, the software is one of the most important sources of revenue by giving licenses to third companies) and a serious issue on the ownership of the software is found, to make resolving the issue a condition precedent or a covenant before the closing would be an important measure to consider.

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Protection under the Copyright Act, Patent Act and UCPA

Computer programs[58] can be protected under the Copyright Act if the expression of such computer program has originality, though the protection does not extend to the programming language, coding conventions or algorithms.

In addition, under certain conditions, inventions related to computer software[59] can be protected by the Patent Act. An invention protected under the Patent Act should be a 'creation of a technical idea utilising the laws of nature'.[60] [61] Under the Examination Guidelines for Patent and Utility Model (the Examination Guidelines),[62] inventions utilising computer software in the following examples are considered to meet this requirement:[63]

1. those concretely performing control of an apparatus or processing with respect to control; or
2. those concretely performing information-processing based on the technical properties such as physical, chemical, biological or electrical properties of an object.

In addition, it is considered that those utilising computer software meet this requirement if 'information processing by the software is concretely realised by using hardware resources'[64] (even in those cases not constituting (1) or (2)).

Not only the boundary of whether computer programs are protected under the Copyright Act, but also the boundary of whether they are protected under the Patent Act is not necessarily clear. In addition, the Copyright Act protects only the expressions of computer programs. Thus, if the software in issue uses source code with different expressions from the original work, it does not constitute an infringement of copyright. On the other hand, even if the expression of source code is not the same as the original work, the right of a patented invention can be asserted if the software in issue achieves the same function and characteristic of the patented invention.

Further, there might be some cases where software provided as 'software as a service' can be protected under the UCPA, since users would not be able to access the object codes of the software and the codes might meet requirements to be protected as trade secrets.

58 The definition of computer program is an expression of a combination of instructions to cause a computer to function in order to be able to obtain a certain result (Copyright Act article 2(1)(x)-2).

59 Computer software means a program related to the operation of a computer or any other information that is to be processed by a computer equivalent to a program (the Examination Guidelines, Part III Chapter 1, Eligibility for Patent and Industrial Applicability 2.2 Note).

60 The Patent Act does not protect mathematical formulae, mental activities of humans, arbitrary arrangements or computer programming languages.

61 To be patented, an applicant has to meet other requirements such as novelty and inventive step, etc.

62 The Examination Guidelines (Part III Chapter 1, 2.2(1)).

63 In addition, the Examination Guidelines (Part III Chapter 1, 2.2(1)) also state: 'computer software for causing a computer to execute a procedure of a method, which is a 'creation of a technical idea utilising the laws of nature' and thus constitutes a statutory 'invention', or a computer or system for executing such a procedure is normally a creation of a technical idea utilising the laws of nature as a whole, and thus, it constitutes a statutory 'invention''.'

64 The Examination Guidelines, (Part III Chapter 1, 2.2(2)).

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Other points to note for computer programs

If a computer program used by the target company is provided by a third party through a licence, checking the contents of the licence agreement is important to ensure the continuous availability to the target company (see section on change of control issues).

If the computer program that is used was developed by a third-party vendor cosigned by the target company, it is also important to check the agreement for software development to find any restriction on the use of the software and other issues.[65] [66] [67]

In addition, there might be some cases where the developed computer program uses open source software. In this case it is important to check the terms and conditions of the relevant open source software licence to see whether there is any restriction on the developed software, such as an obligation to disclose improved source code, etc. Considering these points, collecting information on software licence agreements, agreements on software development and material on the development history is important.

Antitrust law perspective

A detailed explanation from an antitrust perspective in the context of IP is not within the scope of this chapter.[68]

In Japan, the Anti-Monopoly Act (AMA) sets forth the relationship between antitrust and IP law. Specifically, article 21 of the AMA sets forth that: 'The provisions of this Act shall not apply to such acts recognisable as the exercise of rights under the Copyright Act, Patent Act, Utility Model Act, Design Act, or Trademark Act.' Based on this provision, the Japan Fair Trade Commission (JFTC) has published Guidelines for the Use of Intellectual Property under the Antimonopoly Act to deal with various issues involving such relationship, including licence-related issues, etc. The JFTC has also issued Guidelines on Standardisation and Patent Pool Arrangements on antitrust issues in relation to standardisation.

In addition, the JFTC has also issued Guidelines to the Application of the Antimonopoly Act Concerning Review of Business Combination (Guidelines for Review of Business Combination)

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65 For instance, it is important to check whether the related rights are transferred from the vendor to the target company, whether the source code and the related materials are provided to the target company to maintain and improve the software, whether there are any remaining rights that the vendor has, whether there is any encumbrance on the use of the software, whether adapted or extended versions were made, who own the rights of these, whether there is any restriction on improving the software, etc.

66 In addition, with regards to assignment of the rights of software from, for instance, a vendor, to the target company, checking whether the relevant agreement states that the rights stipulated in Copyright Act articles 27 (translation rights, adaptation rights, etc) and 28 (rights of the original author in connection with the exploitation of a derivative work) are clearly transferred is important. This is because Copyright Act article 61(2) states that these rights are not supposed to be transferred if a contract for the transfer makes no particular reference to the rights set forth in articles 27 and 28. In addition, it is important to check whether the non-assertion of moral right of the author (eg, vendor) is included in the said relevant agreement as well since it is considered that the moral right cannot be transferred under Japanese law.

67 Further, it is important to check whether an escrow system is used for the computer program in case the licensor becomes bankrupt.

68 For more information see, eg, *The Intellectual Property and Antitrust Review*: Japan (Shigetomi, Furusho, Hirose), https://thelawreviews.co.uk/title/the-intellectual-property-and-antitrust-review/japan.

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to provide general guidance for M&A transactions from the viewpoint of the effect of restraint on competition. In principle, this does not set out different analytical methods to evaluate the effect of business combinations just because the business combination in issue is related to IP. However, considering, for example, the importance of potential competitiveness derived from data or IPRs, in December 2019, some parts of the Guidelines for Review of Business Combination were amended in relation to evaluating whether restraining competition in a particular field of trade occurs or not by a business combination of parties with important IPRs or data.[69]

Ownership issues in relation to IPRs

Group company issues

See sections on 'Points to note of schemes of M&A transactions' and 'Issues related to the scheme of M&A transactions including change of control and similar issues', as well as 'Buyer side's acquisition of shares issued by target company (share acquisition)'.

Joint ownership of IPRs

Patent, utility model, design and trademark rights

Joint ownership of an industrial property right creates several encumbrances. For instance, where a patent right is jointly owned (except for general succession) a joint owner shall obtain the consent of all the other joint owners in order to assign its own share of the ownership. In addition, to establish a right of pledge on its own share of the ownership, the said consent is also required (Patent Act article 73(1)). Further, a joint owner shall obtain the consent of all the other joint owners in order to grant a licence to third parties (Patent Act article 73(3)). Thus, if the buyer identifies the joint ownership of a patent right and specific succession scheme is used as an M&A scheme, the consents of all other joint owners are required to obtain the relevant share. In addition, if the buyer identifies the joint ownership of important relevant patent right, the buyer has to keep in mind the said encumbrances with regard to utilising the patent rights.[70] On the other hand, unless otherwise agreed, each joint owner may work the patented invention without the consent of the other joint owners (Patent Act article 73(2)).[71]

It should be noted that the Patent Act article 73 shall apply mutatis mutandis to utility model rights, trademark rights and design rights.[72]

69 Examples are Note 5, Note 12 and Note 18 of the Guidelines for Review of Business Combination.

70 Joint ownership creates many encumbrances to use of the relevant IP; thus, if the relevant jointly owned IP is considered essential or important to the buyer, having the seller owe an obligation to acquire the other share of ownership is one of the measures that should be considered. In addition, having the seller owe the obligation to receive consent from the other joint owners to use the relevant IP independently is also a measure that should be considered. Further, if no jointly owned IP is identified, it is better to consider establishing a representation and warranty clause to warrant, for instance, the relevant important IPRs are solely owned by the target company.

71 Further, if a jointly owned patent is infringed, a joint owner is entitled to request injunctive relief and compensation without the consent of the other joint owners.

72 Utility Model Act article 26, Design Act article 36, Trademark Act article 35.

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Copyright

In principle, to assign its own share of the ownership of a jointly owned copyright, to establish a right of pledge on it and to grant a licence, the consent of all the other joint owners is required (Copyright Act article 65(1)(2)). Unlike industrial property rights, for a joint owner to exercise the copyright, the said consent is also required.[73] [74] However, the other joint owners may not, without justifiable grounds, refuse the said consent (Copyright Act article 65(3)).

Joint research and development agreement

Checking joint research and development agreements (joint R&D agreements) is also important. Joint R&D agreements usually stipulate important clauses dealing with newly obtained IPRs such as, for instance, who owns the newly obtained IPRs, how the IPRs may be exercised, whether any restriction on the use of the IPRs exists, how the parties deal with improvement of the IP, who should maintain the IPRs, and whether there is any restriction on research on the deliverables.

One of the important points to check is whether the target company properly receives (or is vested properly with) the important IPRs from its employees or the other parties participating in the joint R&D. Theoretically, it is ideal to include the employees and the third parties working on joint R&D in an M&A agreement as parties. However, in general, this is not practical.[75]

Thus, after collecting the relevant information and checking these issues, it is beneficial to consider,for example, establishing representation and warranty clauses in an M&A transaction agreement to ensure, for instance, that all important IPRs obtained through joint R&D are properly transferred to (or vested in) the target company[76].

Employee inventions (Patent Act) and work for hire (Copyright Act)

Employee inventions (Patent Act)

With regard to inventions, the inventor must be a natural person and in principle the person who originally made the invention has the right to obtain a patent. However, with regard to employee inventions,[77] if an employer makes certain arrangements, such as preparing internal rules for

73 For instance, when a joint owner itself creates copies of the original work for business purposes, in principle consent is required.

74 On the other hand, as with patent rights, if a copyright is infringed, a joint owner is allowed to request injunctive relief and compensation without the consent of the other co-owners (Copyright Act article 117(1)).

75 In particular, it is difficult to collect information on the internal arrangements and rules of the other party to the joint R&D agreement. With regard to copyrights, the Copyright Act has a work for hire system in which an employer can obtain the copyright of its employee without any established internal rule (see VI.D.2.). This means that transferring copyright from the employees of one party to the R&D agreement to the other party is less problematic.

76 In addition, if the IRPs made by the joint R&D is an essential asset of the target company (for instance, it is an important source of revenue or competitiveness) and a serious issue on the ownership (or availability) of the IPRs is found, to make resolving the issue a condition precedent or a covenant before the closing would be an important measure to consider.

77 The employee invention must meet the following three conditions: (1) an invention made by an employee, (2) an invention whose nature falls within the scope of the business of the employer and

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employee inventions before an invention is made,[78] the employer is entitled to be vested with the right from the beginning or receive the right to obtain a patent. On the other hand, the employer has to provide 'reasonable benefit' to the employee. This is called the employee invention system.

Thus it is important for the buyer to check whether the target company has internal rules for employee inventions with the proper content and arrangement. In addition, it is also important to check whether the reasonable benefit has been given to the relevant employee properly. If the reasonable benefit is not paid, there is a risk that the employee will claim compensation from the target company. In order to ascertain such risk, it is important to collect information on the contents and operation of the related internal rules, whether there is any dispute between the target and an employee, whether there is any patent right that produces a large amount in licence fees, whether there is any patent right that is used in the target company's products with a large sales volume, whether there is any patent right used in cross-licensing widely used by competitors, etc.

In addition, it is beneficial to include representation and warranty clauses in an M&A transaction agreement stating, for instance, that employee inventions are properly vested in or transferred to the target company and reasonable benefits have been properly provided.[79]

Work for hire (Copyright Act)

With regard to copyright, in principle the person who creates a work obtains the copyright and moral rights of the work (ie, the principle of the creator doctrine). However, with regard to a work for hire,[80] an employer is automatically vested with the copyright and moral rights of the work from the beginning. In addition, unlike the employee invention system, internal rules for the employer to obtain a work for hire are not required. Further, the employer does not have to provide reasonable benefit to an employee.

(3) an invention achieved by the employee's acts as part of present or past duty of the employee owed to the employer.

78 The internal rule has to state, for instance, that the right to obtain a patent on an employee invention is vested, from the moment the invention is completed, in the employer.

79 In addition, if the buyer finds an unpaid reasonable benefit issue during legal due diligence, it might be beneficial to consider having the seller (or the target company) bear the obligation to clear up the unpaid benefit or (if it is difficult to estimate the total amount of the unpaid benefit in order for the amount of consideration for the M&A transaction to reflect the said unpaid benefit) having a special indemnification clause in the transaction agreement.

80 Requirements for establishing an original work for hire are as follows: (1) the original work is made during the course of employment, (2) the original work is made at the initiative of the employer, (3) the original work is made by the employee of the employer, (4) the original work is made public in the name of the employer, and (5) It is not stipulated otherwise in a contract, in employment rules or elsewhere at the time the work is made. With regard to computer programs, (4) is not required.

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IP-related legal disputes

Cases where a target company is sued based on alleged infringement of a third party's IPRs

It is very important to evaluate legal risks where a target company is (or can be) sued by a third party based on infringement of the IPRs of a third party. An example is the situation where a third party sues a target company, demanding that it suspends sales of products with a large sales volume, claiming a large amount of compensation, or both.

However, during legal due diligence, in general it is not practicable to comprehensively collect and evaluate information on potential legal disputes of this kind. What a buyer mainly can do is to collect information on cases where a target company has already been sued by a third party based on the IPRs of such third party or cases where a target company has actually received a warning letter regarding potential infringement.[81]

Cases where a target company sues a third party infringing IPRs of the target company

As above, it is not practicable to comprehensively collect the relevant information with respect to whether a target company can sue a third party infringing its IPRs. What is practically possible is to collect information on cases where the target company has already sued a third party and potential disputes regarding which the target company has actually considered, for instance, whether to send a warning letter.

In general, the risk derived from cases where a target company is sued based on alleged infringement of a third party's IPRs is more serious than those described here. Nonetheless, the risks should not be underestimated. For instance, consider the circumstance where the target company has been able to achieve a competitive position in a market because of the ownership of a patent right of a certain patented invention and the target company sues a competitor based on an infringement of the patent right. If the target company loses the case because of, for example, invalidity of the patent, the negative impact on the target company will be substantial.

Administrative disputes at the JPO and litigation to cancel a trial decision

Checking, for instance, material on opposition to the grant of patents, trials for patent invalidation at the JPO and litigation rescinding the trial decision is important, especially if they are related to the important relevant patents that are a source of competitiveness in a market. This is because they provide important information on the validity of the said patent.

Representations and warranties

It is, in general, difficult to collect information on the validity of the relevant IPRs and the target company's non-infringement of third parties' IPRs and evaluate the risks thereof. It is important for the buyer to consider, for instance, establishing adequate representations and warranties to

81 It is true that it is not impossible to check, for instance, industrial property rights of third parties that have been registered at the JPO to see whether, for instance, products of the target company infringe them. However, considering the limitation of time for due diligence, the resources available and the potential large numbers of competitors and their IPRs to be checked, etc, it would not be practicable to thoroughly implement such actions.

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cover the risks derived from such matters,[82] which is often a topic of dispute between the seller and buyer since even the seller has difficulty in comprehensively evaluating such risks.

82 In addition, if the buyer discovers litigation where there is high possibility that the target company will lose, the following are examples of measures to consider, depending on the magnitude of the adverse effects arising from the result of the litigation on the target company's business: (1) abandoning the transaction (for instance, if an injunction were to be granted against sales of the target company's products that have a large sales volume or if the patent for a major medical medicine were found to be invalid), (2) decreasing the amount of consideration for the M&A transaction in advance (if it is possible to evaluate the total amount of damage caused to its business) (3) including a condition precedent regarding settlement of the litigation and (4) including a special indemnity clause.

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Appendix 1

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Takashi Hirose is an attorney at law admitted in Japan and in California and a partner in the intellectual property practice group of Oh-Ebashi LPC & Partners.

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Mr Hirose teaches a business law course as a part-time lecturer at Tokyo University of Foreign Studies regarding IP-related law, and he is a vice-chair of the Standing Committee of Commercialisation of IP of the International Association for the Protection of Intellectual Property.

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