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Doing Business in Japan

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CHAPTER 6 Intellectual Property

3-6 Doing Business in Japan § 6.05

§ 6.05 Know-How¹

[1] Definition of Know-how

There are various definitions of know-how. For this discussion, "know-how" is herein defined as "secret technical knowledge and experience or accumulation thereof necessary to practice certain industrial activities, or to develop certain techniques useful for an industrial purpose."

In his article, "Gijutsu Teikei" ("Technical Assistance"), Kenichiro Osumi gives the following analysis of the types of know-how:

Know-how may be divided into (1) tangible materials such as manufacturing methods, formulae, plans, drawings, dies, technical records, written explanations, raw and processed materials, tables, operating instructions and similar things, and (2) intangible materials such as the steps in production, the actual order in which things are done, in detail of implementation, technical experience, training, knowledge obtained from information known to the public and similar things. n1

In Japan, know-how is referred to by various terms in different statutes, such as, "industrial property rights or other rights concerning technology, n2 "manufacturing method by special technique and the like." n3

The Unfair Competition Prevention Act has recently been amended to clearly provide for the protection of trade secrets. n4 The new provision defines a trade secret as technical or business information useful in commercial activities, such as manufacturing or marketing methods, which is kept secret and not publicly known. n5

[2] Know-How as the Subject Matter of Transactions

The extreme importance of know-how in industrial activities has been increasingly recognized in Japan. Know-how, with or without patents, can be the subject matter of an assignment or licensing agreement. n6 Know-how may be entered into a balance sheet of a business as its property or asset if it was acquired for value.

In practice, know-how, like goods, may be part of a contribution to the capital of a new company at the formation of such a company. n7 In other words, a company may issue stocks in exchange for obtaining the ownership or a license of certain know-how. Such an investment is permitted either when know-how is provided as tangible matter, such as,

drawings, or when it is provided as intangible services.

[3] Requirements for Protection

[a] Secrecy. The subject matter of know-how must be secret. Matters that are public knowledge cannot be appropriated by a person as his secrets. However, it is not necessary that only the proprietor of a business possesses its know-how. The proprietor may, without losing his protection, communicate the know-how to his employees involved in its use. He may likewise communicate it to others pledged to secrecy. Matters which are completely disclosed by the goods which one markets cannot be a secret. But when it is difficult, though not impossible (as by reverse engineering), to know the method of manufacture by analyzing the goods, the know-how will not be regarded as public knowledge.

Novelty and invention are not a prerequisite for know-how as they are for patentability.

[b] Intention to Keep Secret. It is an essential requirement for the protection of know-how that the proprietor has an intention to keep it secret. Know-how may be disclosed, but to avoid its becoming public knowledge, the discloser must impose on the disclosee either an express or implied obligation of secrecy.

[c] Interest to Protect Know-How. A person who seeks a judicial remedy to protect his know-how must demonstrate a necessity for such a remedy, especially in the case of an injunction.

[4] Protection Against Unauthorized Acts of Disclosee

Know-how will usually be disclosed to another person in various business relationships, such as, licensing agreements, distributor agreements, engineering agreements, machine leases, and employment agreements.

In these cases, there is a contract between the owner of the know-how (discloser) and the party to whom he discloses it (disclosee). It is usual for such an agreement to contain provisions prohibiting the disclosee from misappropriating or leaking the know-how during the period of, and even after, the termination of such an agreement. Usually such an agreement will provide that any unauthorized misappropriation or leakage of know-how by the disclosee will constitute a breach of the contract. But even if there is no provision in the contract to prohibit the disclosee from misappropriating or leaking the know-how, the agreement establishes a relationship of confidence or trust between the parties. Thus, any breach of confidence or trust by the disclosee will be interpreted as a breach of an implied contractual promise not to make unauthorized disclosures. Therefore, the same remedies will be granted to the owner of the know-how as in the case of a breach of a contractual obligation-duty. n8

[5] Protection Within a Business Organization

[a] Generally. For the purpose of carrying on business activities, know-how is usually disclosed to certain persons working for or employed by the business. Often it is a commercial necessity for the business to require such persons not to divulge or misappropriate the business's know-how. There are some statutory laws imposing an obligation on such persons not to disclose, but the application of such law is limited to certain circumstances.

[b] Directors, Managers and Commercial Agents. A director of a company cannot undertake any transaction within the type of business carried on by that company on the director's own behalf or on behalf of a third person without the approval of a general meeting of shareholders. n9

A manager of a business may not without the permission of the business's proprietor carry on business or effect any transaction falling within the scope of the proprietor's business on the manager's own behalf or on behalf of a third person, nor can the manager become a member with unlimited liability or a director of another company, or an employee of another business. n10

A commercial agent cannot, without the permission of his principal, transact, on his own behalf or on behalf of a third person, any business which falls within the scope of his principal's business, or become a member with unlimited liability or a director of a company doing the same kind of business. n11

Beyond the above three statutorily designated employees, there is no statutory provision to prohibit other officers and employees of a business from carrying on competitive business activities. However, it is suggested that these employees too have an obligation similar to that of a manager of a business.

[c] Employees. It is common for an employer to have general shop regulations or rules of employment (*shugyo kisoku*) governing his employee's activities and responsibilities, and these often include an obligation to maintain the employer's secrets. It is generally accepted that the provisions contained in such shop regulations are to be regarded as among the provisions in the employment agreement. However, such general provisions have two defects: (1) they may be ambiguous as to the scope of information protected, and extent and duration of the secrecy obligation, and (2) as a part of the basic employment agreement, there is uncertainty as to whether they continue once the employee is terminated. Thus, when an employee is expected to have dealings in his employer's secrets, it is best to prepare a special secrecy agreement defining the employee's secrecy obligation and dealing with the problem of termination.

[d] Former Directors, Officers and Employees. A contract which provides that a director, officer or employee of an enterprise shall not, upon ceasing his relationship with the business concerned, divulge or misappropriate know-how, or any other matters of the business, is enforceable within certain necessary reasonable limits if certain conditions are satisfied.

In *Foseco Japan Ltd. v. Okuno et al.*, n12 the Nara District Court granted a preliminary injunction in favor of the proprietor of know-how against the proprietor's ex-employees. In this case, the two defendants were staff members paid a special allowance to work in the Research and Development Section of the plaintiff's company. In assuming their duties, the employee defendants had each signed an agreement not to disclose to others any secrets obtained during their employment even after the termination of their employment and not to directly or indirectly work for any enterprise competing in a narrowly-defined technical specialty of their employer within two years following the termination of their employment. After resigning from the plaintiff's employ, the defendants became directors of a competing company and used the know-how learned during their period of employment. The court ordered the defendants not to engage in the business of producing products which used the know-how of the plaintiff for the agreed two-year term. The court stated that generally an agreement restricting a former employee from working for a competing business firm is, without special reasonable circumstances, void as against public order because it would deprive the employee of his means of livelihood, restrict the employee's freedom of choice of occupation, and lead to unjust monopoly. However, the court found that it was legal and effective to impose on a specially paid key employee using know-how an obligation not to engage in a competing business for a limited period, for the purpose of protecting his employer's know-how learnt by that employee. The court also found that while the absence of a territorial limitation in such an employee obligation might cause its invalidity, in this case where the employer's business activities were in a limited technical specialty engaged in throughout the country, the absence of a territorial limitation was reasonable.

[6] Protection Against Third Parties

Even where a confidential relationship exists, a third party to that relationship may learn the contents of the know-how of the relationship by (1) using improper means of discovery, or (2) learning the know-how from another person, with or without notice that it is someone's secret property, and that such other person discovered the know-how by improper means or that such other person's disclosure of it is a breach of his duty to the know-how owner.

Generally speaking, in tort law a person who intentionally or negligently violates the right of another person is liable for any resulting damages. n13 In the tort law, the term "right" is interpreted very broadly to include various non-statutory social interests as well as special rights provided by statute. As a result, a person who unjustly infringes another person's

social interest can be liable for the resulting damages.

A "know-how right" had never been specifically defined and created by law in the same manner as the "patent right" or the "trademark right." Therefore, courts appear to be reluctant to find that know-how is the kind of "right" or "interest" to be protected from violation by a third party. The Tokyo High Court, for example, refused an injunction against a third party based on misappropriation of know-how. n14

In this case, the German plaintiff know-how owner had granted an American company, Waukesha Bearings Co., a license only in the U.S. and Canada to manufacture and sell oil lubricated ship propellor shaft tube sealings using the German company's know-how. Waukesha and a Japanese company (Chuetsu) had later established a joint-venture company in Japan, the defendant Waukesha Chuetsu, 45 percent of whose shares were held by Waukesha Bearing Co. Without authorization of the German company, the Japanese joint-venture company began to manufacture and sell the products using the German company's know-how which had been disclosed to Waukesha Bearing Co. The German know-how owner sued for a preliminary injunction against the Japanese joint-venture company. The Tokyo High Court rejected the injunction request because, while there was a breach of the know-how license agreement by Waukesha Bearing Co., the defendant joint-venture, Waukesha Chuetsu, was a separate legal person not a party to the agreement. The High Court also found that without statutory authority it could not enjoin such a third party's unauthorized use of the know-how even though there was resulting loss to the Germany company. Some legal scholars have voiced strong objection to this judgment saying that know-how should be a protectible proprietary interest in the sense of Article 709 of the Civil Code. Other scholars say that the use of the know-how by the Japanese joint-venture company was a knowing interfering violation of the German know-how proprietor's contractual interest.

The Unfair Competition Prevention Act has been recently amended to provide for protection of trade secrets against infringements by third parties. The owner of a trade secret is entitled to make a claim for the discontinuance or prevention of any act of misappropriation thereof. An act of misappropriation of a trade secret means any of the following: n15

1. the act of acquiring a trade secret by improper means such as theft, fraud, or coercion, or the act of using or disclosing a trade secret so acquired;
2. the act of acquiring a trade secret with the knowledge or without the knowledge due to one's own gross negligence, that a prior act of improper acquisition of the trade secret has occurred in the process of acquiring it, or the act of using or disclosing a trade secret so acquired;
3. the act of using or disclosing a trade secret after the acquisition thereof, with the knowledge or without the knowledge due to one's own gross negligence, that a prior act of improper acquisition of the trade secret has occurred in the process of acquiring it;
4. the act of using or disclosing a trade secret which has been properly disclosed by its owner for the purpose of committing unfair competition or other acts bringing an unfair benefit, or for the purpose of causing harm to the owner;
5. the act of acquiring a trade secret, with the knowledge or without the knowledge due to one's own gross negligence, that an act of improper disclosure has resulted in the acquisition thereof, or a prior act of improper disclosure has occurred in the process of acquiring it, or the act of using or disclosing a trade secret so acquired; and
6. the act of using or disclosing a trade secret after the acquisition thereof, with the knowledge or without the knowledge due to one's own gross negligence, that an act of improper disclosure has resulted in the acquisition thereof, or a prior act of improper disclosure has occurred in the process of acquiring it.

Damages may also be given in cases where the act of infringement is committed intentionally or negligently. n16 An order for the restoration of the business reputation of the injured party may also be granted in lieu of damages or in addition thereto. n17

[7] Unfair Trade Practices

It is an unfair trade practice under the Antimonopoly Act to unjustly induce, abet or coerce a shareholder, director or auditor of a competing entrepreneur to act against the interest of such a company by divulgence of secrets. n18

It is also an unfair trade practice to unjustly interfere with a transaction between a competing entrepreneur and a third party to that transaction by preventing the execution of a contract. n19 Inducing or otherwise persuading a director or employee of a competitor in order to obtain the know-how of that competitor falls under the above Item 12. In some circumstances, to induce an employee of a competitor to make disclosure will come under the above Item 11.

[8] Civil Procedure

In principle, a civil action is tried in open court. Under Article 265 of the Code of Civil Procedure, it is possible to have examination of evidence heard in camera. However, the record of such examination of evidence has to be submitted to the court conducting the hearing. In conclusion, there is no procedure to try the whole of a civil action in camera. However, at arbitration, a matter may be heard in private. The record or arbitration is also kept secret.

In know-how litigation, the other party also usually prefers to try the matter in secret. Therefore, it will usually be possible for both parties to agree to arbitration or to oppose submission of documents before any proceeding is instituted.

[9] Know-How and Criminal Law

Some administrative laws provide criminal punishment for the person who divulges a certain secret to which he has had access in the course of his service. n20 However, there is no general criminal provision for the protection of secrets of a business.

Article 318 of the Draft for Criminal Code Amendment Act provides that a director or an employee of a business who has divulged a manufacturing process or other secret concerning the technique of that business shall be punished by imprisonment not exceeding one year or fine not exceeding five hundred thousand yen.

Article 317 of the Act provides that if a person, who is engaged in a profession in which he is informed of another person's secret on the basis of a confidential relationship or his assistance, divulges such a secret disclosed to him in connection with the performance of his professional duties, he shall be punished by imprisonment not exceeding one year or a fine not exceeding two hundred thousand yen.

However, strong objection has been raised to these clauses on the ground that they would restrict the freedom of citizens.

[10] Protection of Computer Software

Some kinds of computer software may be patentable, n21 but protection under a patent is restricted under present patent office practice. There is an official study being conducted in the Ministry of Trade and Industry to develop a protection system for computer software. The Report of the Research Committee for Legal Protection of Software in May 1972 proposed a registration system for computer programs to be managed by a semi-governmental organization. Any computer program thus registered would have an effect like a patent or copyright. But this proposal has not yet been

realized. Thus, at present, the most effective method for protection of computer software is to deal with it as know-how to be protected by contractual arrangements.

In a case based on the relationship between a contractor and its subcontractor, the Tokyo District Court ordered a subcontracting company holding a magnetic tape containing a coded customer list to pay damages arising from the unauthorized copying of the list. n22 In this case, plaintiff Athena was a business service that kept for its clients a confidential address tape containing more than 80,000 customers. Athena ordered defendant Nagonoken Computing, Athena's subcontractor, to perform some computerized work using this confidential address tape. During Nagonoken's performance of the work, a third party made a duplicate of the address tape and sold it to a competitor of the owner who had entrusted the address tape to Athena. When the owner of the address tape learned of the unauthorized copying, it cancelled its service agreement with plaintiff Athena. Athena then sued the subcontractor Nagonoken for damages.

The Tokyo District Court ordered defendant Nagonoken to pay Athena ¥4,500,000 (about \$22,500) for its lost profit on the service contract stating that (1) the duties imposed upon the defendant subcontractor by law included a duty to be careful not to negligently reduce the value of the information contained in the address tape entrusted to it, and (2) the defendant had negligently permitted leakage of such information to the detriment of Athena.

FOOTNOTES:

(n1)Footnote 1. This section will be revised shortly.

(n2)Footnote 1. 11 *Keiei Hogaku Zenshu* (Compendium of Business Law) 30 (Diamond Co., Tokyo, 1967). English translation of A. Calhoun in K. Osumi, *Know-How and Its Investment*, 1964, Law in Japan 92 (Univ. of Washington, 1964).

(n3)Footnote 2. Foreign Exchange and Foreign Trade Control Act, Art. 29 para. 1.

(n4)Footnote 3. Income tax Act and Corporation Tax Act.

(n5)Footnote 4. Law No. 66, June 29, 1990, effective as of June 1, 1991.

(n6)Footnote 5. Unfair Competition Prevention Act, Article 1 paragraph 3.

(n7)Footnote 6. Foreign Exchange and Foreign Trade Control Act, Art. 29.

(n8)Footnote 7. *See*, as to contribution-in-kind (*genbutsu shusshi*), Commercial Code, Art. 168, para. 1, item 5, and para. 2; Art. 172; Art. 173, para. 1; and Art. 177, para. 3.

(n9)Footnote 8. For example, see Civil Code, Art. 415 (Breach of Contract).

(n10)Footnote 9. Commercial Code, Art. 264, para. 1.

(n11)Footnote 10. *Id.*, Art. 41.

(n12)Footnote 11. *Id.*, Art. 48.

(n13)Footnote 12. 624 Hanrei Jiho 78, Oct. 23, 1970.

(n14)Footnote 13. Civil Code, Art. 709.

(n15)Footnote 14. *Deutsche Werft Akitengesellschaft v. Waukesha Chuetsu Yugengaisha*, Tokyo High Court, 464 Hanrei Jiho 34, Sept. 5, 1966.

(n16)Footnote 15. Unfair Competition Prevention Act, Article 1 paragraph 3.

(n17)Footnote 16. *Id.*,Article 1-2 paragraph 3.

(n18)Footnote 17. *Id.*,paragraph 4.

(n19)Footnote 18. Fair Trade Commission Guidelines for the Regulation of Unfair Trade Practices with respect to Patent and Know-How Licensing Agreements, Feb. 15, 1989, Part 2.

(n20)Footnote 19. *Id.*, Item 11.

(n21)Footnote 20. National Public Servants Act, Art. 100; Patent Agent Act, Art. 22.

(n22)Footnote 21. *See* § 2.01[7] *supra*.

(n23)Footnote 22. K.K. Athena v. K.K. Nagonoken Keisanki Center, Tokyo District Court, 713 Hanrei Jiho 83, Feb. 19, 1973.