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## Efforts to Establish Clear Standards for Exhaustion in Japan

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EFFORTS TO ESTABLISH CLEAR STANDARDS FOR  
EXHAUSTION IN JAPAN

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ABSTRACT

*The Honorable Chief Judge Rader has often emphasized the importance of establishing clear standards in the field of patent law. Similarly, Japanese courts in this field seem to make an effort to present a clear rule in their holdings. Patent exhaustion theory is one of the fields where a clear and concrete standard by the courts is especially needed. This Article explains several clear standards held by Japanese courts regarding this issue. It then discusses a problem raised by establishing clear standards by courts in a civil law country like Japan and also presents the Japanese Government's efforts to ensure legal predictability in the patent field.*

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## INTRODUCTION

The Honorable Randall R. Rader is Chief Judge of the United States Court of Appeals for the Federal Circuit (CAFC), a court with exclusive jurisdiction over patent lawsuits. Judge Rader’s remarks have earned full respect and attracted enormous attention from the intellectual property field in not only the United States but also other nations, including Japan. Judge Rader has often expressed his view that businesses need clear patent law jurisprudence so that they can avoid costly litigation.<sup>1</sup> Based on

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<sup>1</sup> Most recently, Judge Rader mentioned his thoughts in his speech at the

this premise, Judge Rader has been establishing clear standards in his judicial opinions.<sup>2</sup> Japanese courts seem to make an effort to present a clear rule in patent law cases that come before them as well.

The mentality of Japanese courts seems to have greater significance for the legal system than that of American courts. Under the principle of *stare decisis*, the courts in the United States have the ability to create laws through handling disputes. Therefore, in the United States, the courts can establish clear and enforceable standards that can be applied to subsequent cases where the facts are similar to the case decided. On the other hand, courts in Japan, a civil-law country, interpret a statutory law and apply it only to the facts of a particular case. The main effect of a final and binding judgment in Japan is *res judicata*, where the scope of persons subject to the ruling is basically limited to the parties of the case decided.<sup>3</sup> Although the courts in Japan tend to use important cases for reference in practice, there is no principle of *stare decisis*. Therefore, generally speaking, the courts in Japan seem to place greater emphasis on the validity of the ruling for a particular case rather than creating legal predictability.

Moreover, Japanese courts try to minimize the need to interpret a statutory law when they apply it to a particular set of facts. In other words, in the Japanese legal system, the courts in general seem unwilling to present clear and concrete rules, aside from interpretations necessary to understand the abstract wording of the statutory law. However, in the patent field, the courts seem bravely to state clear standards in their decisions.

Patent exhaustion theory is one of the fields where a clear and concrete standard by the courts is especially needed because the statutory law is ambiguous and because the consequence of a lawsuit significantly affects the parties. This Article focuses on the

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symposium held by Tongji University, Shanghai, China on October 30, 2011.

<sup>2</sup> For example, the three conditions required for applying the entire market value rule are shown in *Cornell Univ. v. Hewlett-Packard Co.*, 609 F. Supp. 2d 279, 286-87 (N.D.N.Y. 2009), and the materiality standard for inequitable conduct is shown in *Therasense, Inc. v. Becton, Dickinson & Co.*, 649 F.3d 1276, 1291-94 (Fed. Cir. 2011).

<sup>3</sup> *Minji soshōhō* [Minsohō] [C. Civ. Pro.] 1996, art. 115, para. 1 (Japan).

exhaustion theory, explaining several cases where the courts established clear standards and discussing the impact of such cases.

## I. EXHAUSTION THEORY IN JAPAN

### A. Introduction

We take it for granted that once a patentee has assigned a patented product in Japan, the patentee cannot enforce his patent right against those who subsequently use or sell the patented product. However, because there is no statute excluding these activities by patent users or sellers from infringement, these activities could technically constitute infringement.<sup>4</sup> To avoid such an unjust conclusion, various theories have been put forward. The prevailing theory in Japan states that a patent right over a patented product is exhausted by a lawful distribution of that product.<sup>5</sup> This theory is known as the doctrine of patent exhaustion.

Within the broader doctrine of patent exhaustion, a narrower issue with regard to international exhaustion has been analyzed: whether a patent right in Japan will be exhausted when the patentee or a person equivalent thereto has assigned a patented product to a third party outside Japan. This issue was resolved by the *BBS* case.<sup>6</sup> However, a newer issue, whether a patent right is still exhausted when a third party has processed the patented product or replaced elements of the product after the product was assigned by a patentee, has also been raised. Companies commonly try to use a purchased patented product for an extended period of time by repairing or replacing elements of the product. Companies use this “recycle” strategy to ensure effective utilization of limited

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<sup>4</sup> See Tokkyohō [Patent Act], Law No. 121 of 1959, art. 2, para. 3 (last amended in 2006) (Japan).

<sup>5</sup> NOBUHIRO NAKAYAMA, KŌGYŌSHOYŪKENPŌ (JŌ) TOKKYOHŌ [INDUSTRIAL PROPERTY LAW: VOLUME 1, PATENT LAW] 362-65 (2d ed. 1998).

<sup>6</sup> Saikō Saibansho [Sup. Ct.] Jul. 1, 1997, Hei 7 (o) no. 1988, 51 Saikō Saibansho Minji Hanreishū [Minsyū] 2299 (Japan) (“[A] patentee in Japan who assigned a patented product in a foreign country . . . shall not exercise his patent right with regard to the product in Japan against the assignee unless they had agreed to exclude Japan from the areas where the assignee can sell or use the product, . . .”).

resources, and the growth of the recycle business has been rapid. As a result, there are a growing number of single-use products that are reused by such recycle companies. There are a number of lower-court decisions and scholarly theories addressing this issue. The *BBS* case could not resolve the recycling patent issue because the patented product at issue in this case was imported and sold in Japan without being repaired or partially replaced.

In this Article, we briefly explain the dicta of the *BBS* case, in which the Supreme Court of Japan adopted the domestic exhaustion theory and expressed the reasons for the doctrine's adoption. Next, we introduce major lower courts' decisions and scholarly theories on the issue of whether a patent right is exhausted when a patented product has been processed or partially replaced. Finally, we will explain the *Ink Cartridge* case,<sup>7</sup> where the Grand Panel of the Intellectual Property High Court (IP High Court) and the Supreme Court of Japan ruled on this issue for the first time.

### B. *BBS Case*

In the *BBS* case, the owner of a patent right both in Japan and Germany filed an infringement action based on its Japanese patent against companies who imported the patented products produced and sold by the patentee in Germany to Japan (parallel importation). The main issue of this case was the doctrine of international exhaustion. However, in dicta, the Supreme Court adopted the domestic exhaustion of a patent right and stated the following three rationales for its adoption:

- (1) Inventions should be protected by the Patent Act while keeping in harmony with public interest;
- (2) The assignor generally transfers all rights to the assigned product to the assignee. In other words, when the patented product is placed on the market, the product is assigned to the assignee on the

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<sup>7</sup> Chiteki Zaisan Kōtō Saibansho [Intellectual Prop. High Ct.] Jan. 31, 2006, Hei 17 (ne) no. 10021, 1922 Hanrei Jihō [Hanji] 30; Saikō Saibansho [Sup. Ct.] Nov. 8, 2007, Hei 18 (ju) no. 826, 1990 Hanrei Jihō [Hanji] 3 (Japan).

premise that the assignee will obtain the rights to use and reassign the product. Requiring the assignee to obtain a license from the patentee every time he assigns the patented product would obstruct free circulation of products in a market, resulting in detrimental consequences to the patentee's interests. This would also violate the purpose of the Patent Act, i.e., "through promoting the protection and the utilization of inventions, to encourage inventions, and thereby to contribute to the development of industry" (Patent Act, art. 1);

(3) By receiving the payment from the sale which includes compensation for disclosing the patented invention when the patentee assigns the patented product or by receiving royalty when the patentee grants a license, the patentee is guaranteed the opportunity to secure his reward for the disclosure of the patented invention. Therefore, there is no need for the patentee to receive a double benefit during the course of distribution of the product which the patentee or the licensee has assigned.<sup>8</sup>

These rationales for the domestic exhaustion doctrine have significantly affected the subsequent lower court decisions with regard to the issue of the exhaustion when patented products are wholly or partially processed or replaced by a third party.

### *C. Major Lower Court Cases*

#### 1. *Konica* case<sup>9</sup>

In *Konica*, the defendant was accused of refilling the used plastic housings of disposable cameras—products that are covered by utility model design rights—with new film and batteries and

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<sup>8</sup> Saikō Saibansho [Sup. Ct.] Jul. 1, 1997, Hei 7 (o) no. 1988, 951 Hanrei Taimuzu [Hanta] 105, 110-11 (Japan).

<sup>9</sup> Tōkyō Chihō Saibansho [Tōkyō Dist. Ct.] Jun. 6, 2000, Hei 11 (yo) no. 22179, 1712 Hanrei Jihō [Hanji] 175 (Japan).

selling the refilled product. The district court held, based on the second rationale for the domestic exhaustion doctrine stated in the *BBS* case, as follows:

[The domestic exhaustion doctrine is adopted because] the assignor generally transfers all rights to the assigned product to the assignee. In other words, when a product covered by an intellectual property right is placed on the market, the product is assigned to the assignee on the premise that the assignee will obtain the rights to use and reassign the product without being accused. . . . In a case where, by judging from the nature of the product, the character of the transaction, and utilization form of the product in accordance with social convention, the right holder may not necessarily grant the assignee unqualified rights to use and reassign the assigned product free from being accused, the right holder may exercise his right as long as the assignee's activity exceeds the qualified scope of activity.<sup>10</sup>

The district court found that because the product at issue was a disposable camera in which only pre-equipped film was supposed to be used, the accused activity was beyond the scope of activity foreseen by the right holder as of the assignment.<sup>11</sup> Accordingly, the district court concluded that the utility model right and the design right had not been exhausted.<sup>12</sup>

## 2. *Fujifilm* case<sup>13</sup>

The facts of this action were based on a patent right relating to a disposable camera and were almost the same as the *Konica* case.

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<sup>10</sup> *Id.* at 179.

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> Tōkyō Chihō Saibansho [Tōkyō Dist. Ct.] Aug. 31, 2000, Hei 8 (wa) no. 16782, Saikō Saibansho Saibanrei Jōhō [Saibanrei Jōhō] 1, *available at* <http://www.courts.go.jp> (Japan).

As a basis for domestic exhaustion, the district court explained that a patented product is placed on the market on the premise that the assignee will obtain the rights to use and reassign the product without being accused.<sup>14</sup> In *Fujifilm*, the district court further held that the “rights to use and reassign” are transferred to the assignee on the presumption that the function of the product still remains.<sup>15</sup> In other words, a patent right would not be exhausted after the function of the patented product is depleted.<sup>16</sup> The district court explained that the assignee is not supposed to use or reassign the patented product after the function of the product has been depleted due to abrasion or deterioration and that the patentee would not receive double profits from the patented product through exercising his right after the function of the product has been depleted.<sup>17</sup>

Furthermore, the district court proposed another situation in which a patent would not be exhausted. Specifically, the district court hypothesized a situation where a third person replaces an element of a patented product that corresponds to the essential part of the patented invention, with the resulting product not being equivalent to the original patented product.<sup>18</sup> However, the district court explained that when a useful life span of the replaced element is shorter than that of the product as a whole, or where the product is merely repaired by replacing a damaged part, the resulting product would not lose the identity of the original one.<sup>19</sup>

The district court held that the function of the deposable camera at issue was depleted when it was used up and, therefore, the patent exhaustion should be denied.<sup>20</sup>

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<sup>14</sup> *Id.* at 9.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* at 10.

<sup>19</sup> Tōkyō Chihō Saibansho [Tōkyō Dist. Ct.] Aug. 31, 2000, Hei 8 (wa) no. 16782, Saikō Saibansho Saibanrei Jōhō [Saibanrei Jōhō] 10, *available at* <http://www.courts.go.jp> (Japan).

<sup>20</sup> *Id.* at 11.

3. *Hammer* case<sup>21</sup>

This case occurred in 1988, nine years before *BBS*. While the product at issue, which was covered by a utility model right, had a useful life span of two or three years, one consumable element of the product had a lifespan of at most one week. The issue in *Hammer* was whether the exchange of such a consumable element constituted infringement of the utility model right.

The district court explained that the substantial rationale for domestic exhaustion as follows:

In a situation where the assignee replaces a part of the assigned product for the reason that the product has malfunctioned before the expected purpose of use of the product is accomplished, this replacement is permissible as repair because this activity is within the scope of activity recovering the amount of the purchase price. On the other hand, in a situation where [an] assignee replaces a part of the product after the assignee has recovered the amount of the purchase price by accomplishing the expected purpose of use of the product, this replacement is not permissible because this activity is equivalent to freshly utilizing the device which is beyond the scope of activity recovering the amount of the purchase price.<sup>22</sup>

The district court in *Hammer* found that the replacement at issue was not a replacement of a malfunctioned part; therefore, the court held that this activity constituted impermissible “manufacturing.”<sup>23</sup>

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<sup>21</sup> Ōsaka Chihō Saibansho [Ōsaka Dist. Ct.] Apr. 24, 1988, Sho 60 (wa) no. 6851, 1315 Hanrei Jihō [Hanji] 120 (Japan).

<sup>22</sup> *Id.* at 128.

<sup>23</sup> *Id.* at 128-29.

4. *Aciclovir* case<sup>24</sup>

In this case, a patented product was processed rather than partly replaced. The defendants bought a pharmaceutical compound containing the patented drug aciclovir as an active ingredient. They extracted and purified the aciclovir, then produced and sold a new pharmaceutical compound containing the resulting aciclovir as an active ingredient.

The district court held the same way as the *Fujifilm* court, i.e., that domestic exhaustion was denied when: (1) a functionally depleted patented product was reused; or (2) an element of a patented product corresponding to the substantial part of the patented invention was replaced.<sup>25</sup> The district court concluded that the patent right at issue was exhausted because the situation in this case did not fall into either category.<sup>26</sup>

The high court upheld the conclusion of the district court on different grounds. The high court explained that a patent right may be exhausted with respect to the assignee's activities, such as using and assigning, but may not be exhausted with respect to the assignee's manufacturing activity.<sup>27</sup> Therefore, if the assignee's activity is evaluated as manufacturing a new product, it constitutes infringement of the patent right.<sup>28</sup> The high court established a standard to determine whether the assignee's activity constitutes "manufacturing" or not, as follows:

Replacing an element of a patented product which corresponds to the essential part of the patented invention is typically recognized [as manufacturing.] . . . Whether an activity processing the patented product is within a scope of a mere

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<sup>24</sup> Tōkyō Kōtō Saibansho [Tōkyō High Ct.] Nov. 29, 2001, Hei 13 (ne) no. 959, 1779 Hanrei Jihō [Hanji] 89 (Japan). Since the IP High Court had not yet been established in 2001, the Tokyo High Court heard this case.

<sup>25</sup> Tōkyō Chihō Saibansho [Tōkyō Dist. Ct.] Jan. 18, 2001, Hei 11 (wa) no. 27944, 1779 Hanrei Jihō [Hanji] 99, 104-05 (Japan).

<sup>26</sup> *Id.* at 106.

<sup>27</sup> Tōkyō Kōtō Saibansho [Tōkyō High Ct.] Nov. 29, 2001, Hei 13 (ne) no. 959, 1779 Hanrei Jihō [Hanji] 89, 96 (Japan).

<sup>28</sup> *Id.*

repair or evaluated as manufacturing a newly patented product will be determined based on a structure and working-effect or technical idea of the patented invention. In other words, we should determine, by judging from the nature of the product and utilization form of the product, whether the activity constitutes manufacturing a new product, or the activity does not change the identity of the original patented product, such as activity of repairing in order to accomplish the lifetime of the product. . . . [Responding to the patentee's assertion that exhaustion of a patent right should be denied if the patented product was processed in a way that the patentee had never expected,] a patent right should be exhausted unconditionally by assigning a patented product by the patentee, regardless of the patentee's intent.<sup>29</sup>

The high court found that the defendants' activity did not yield any chemical reaction with regard to the aciclovir, nor did this activity produce any new aciclovir by some chemical reaction.<sup>30</sup> Accordingly, the high court held that the defendants' activity did not constitute manufacturing aciclovir, and therefore a patent right should not be effective against such activity.<sup>31</sup>

#### *D. Major Scholarly Theories*

1. Theory focusing on full value of a patented invention received by a patentee

As a rationale of the patent exhaustion doctrine, Professor Tamai explains that because a patentee receives "full value" for a patented invention when he or she first assigns a patented product, the law need not allow recovery of the "full value" again with

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<sup>29</sup> *Id.* at 97.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

regard to the product.<sup>32</sup> Under this principle, the patentee may sufficiently recover “full value” when he or she assigns the patented product.<sup>33</sup> Thus, when a patent right has been exhausted by assigning the patented product, the assignee may replace a part of the product without infringing the patent right regardless of whether the replaced part is “substantial” and “essential” structure for the patented invention.<sup>34</sup>

On the other hand, in the light of principle of “full value,” partially replacing or processing the product for reuse after the function thereof has been depleted constitutes infringement of the patent right.<sup>35</sup> Therefore, in a case where a third party’s activity is beyond the scope of activities assumed with respect to a patented product under normal social conventions as of the assignment of the product, the patentee may exercise the patent right because the full value of the product with regard to this activity is not yet recovered.<sup>36</sup>

## 2. Theories focusing on classification of permissible repairing and impermissible manufacturing

Mr. Kōsaku Yoshifuji considers an act of repairing or processing with regard to a patented product as infringement of a patent right if this act constitutes “manufacturing.”<sup>37</sup> Specifically, he divides a patented product into two portions: a patented portion, which has the features of the patented invention, and a non-patented portion.<sup>38</sup> Then, he explains that while repairing or processing of a non-patented portion may not constitute

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<sup>32</sup> Katsuya Tamai, *Nihonkokunai niokeru tokkyoken no syōjin* [Exhaustion of a Patent Right in Japan], in *Shin-Saibanjitumutaikai 4 Titekizaisankankei soshōhō* [New Outline of Practice in Court, Litigation Laws relating to Intellectual Property], 233, 240 (Toshiaki Makino & Toshiaki Iimura eds., 2001).

<sup>33</sup> *Id.* at 244.

<sup>34</sup> *Id.* at 247-48.

<sup>35</sup> *Id.* at 250.

<sup>36</sup> *Id.*

<sup>37</sup> Kōsaku Yoshifuji & Kenichi Kumagai, *Tokkyohō Gaisetsu* [Overview of Patent Act], 434 (13th ed. 1998).

<sup>38</sup> *Id.* at 435.

infringement of the patent right, that of a patented portion may constitute infringement depending on the degree of such repairing or processing.<sup>39</sup>

Professor Nobuhiro Nakayama explains that because it is common for an assignee to repair or improve the assigned product during his use and because it would be inconsistent with the conventional understanding of laws if such activity is recognized as manufacturing, only the repair or processing of an essential part of the patented product can be understood as manufacturing.<sup>40</sup> With regard to a disposable product such as a disposable camera, he explains that refilling a used product with some parts and selling the product thus obtained may generally constitute infringement because the activity is beyond the traditional form of repair, although it of course depends on the purpose of the product, the nature of the patent right and the portion covered by the patent right.<sup>41</sup>

Mr. Kazuo Masui suggests a two-part test for determining infringement: (1) the “exhaustion issue” to determine whether the act of replacing constitutes legitimate “repairing,” or “re-manufacturing” which requires the right owner’s permission, and (2) the “infringement issue” to determine whether the right owner has granted explicit or implicit permission to replace if the activity constitutes “re-manufacturing.”<sup>42</sup> As for the first test, he explains that the issue of exhaustion should be considered objectively, abstracting the concrete circumstance between the right owner and the assignee, and determined by whether the activity is equivalent to manufacturing a patented product.<sup>43</sup>

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<sup>39</sup> *Id.*

<sup>40</sup> Nakayama, *supra* note 5, at 315.

<sup>41</sup> *Id.*

<sup>42</sup> Kazuo Masui & Yoshiyuki Tamura, Tokkyo Hanrei Gaido [Guide of Patent Cases], 252-53 (2d ed. 2000).

<sup>43</sup> *Id.* at 253.

### 3. Theories embracing classification of repairing and manufacturing and classification based on expected “use” under normal social conventions

Professor Hisayoshi Yokoyama divides the major lower court cases and the scholarly theories into two categories: a “manufacturing approach” that concerns whether an act of processing is evaluated as manufacturing, and an “exhaustion approach” that concerns whether an act of processing is within a scope of “use” foreseen under normal social conventions.<sup>44</sup> He explains that these conflicting approaches stem from the gap in viewpoints regarding protection of a patent right; i.e., while the manufacturing approach focuses on things protected by a patent right, the exhaustion approach focuses on the function of a patent right as a means of the recovery of investment.<sup>45</sup> He mentions that either view may be plausible; however, the question is which view should be emphasized.<sup>46</sup>

#### *E. Ink Cartridge Case*<sup>47</sup>

##### 1. Factual Background

In this case, the plaintiff, an owner of a patent right relating to an ink tank for an inkjet printer, produced an ink cartridge as a patented product and sold it. The defendant’s accused infringement, in pertinent part, was refilling used ink tanks with ink and selling the products thus obtained.

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<sup>44</sup> Hisayoshi Yokoyama, *Tokkyoseihin nitaisuru Henkeikōi to Tokkyokenshingi* [Act of Processing a Patented Product and Infringement of a Patent Right], 170 *Bessatsu Jurisuto* 130, 131 (2004).

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Chiteki Zaisan Kōtō Saibansho* [Intellectual Prop. High Ct.] Jan. 31, 2006, Hei 17 (ne) no. 10021, 1922 *Hanrei Jihō* [Hanji] 30 (Japan); *Saikō Saibansho* [Sup. Ct.] Nov. 8, 2007, Hei 18 (ju) no. 826, 1990 *Hanrei Jihō* [Hanji] 3 (Japan). In this case, several issues including the doctrine of international exhaustion were discussed. However, in this paper, we focus on the issue of the domestic exhaustion with regard to invention of a product.

## 2. Holding of the IP High Court

The Grand Panel of the IP High Court heard this case on appeal. The IP High Court denied a notion focusing on the classification of permissible repairing and impermissible manufacturing and held the same way as the *Fujifilm* court; specifically, the IP High Court determined that a patent right is not exhausted in the following situations and thus a patent right is enforceable with regard to the patented product:

- (1) where the patented product is reused or recycled after its function has been depleted due to the expiration of the original life span of the product (First Category), or
- (2) where a third person processes or replaces the whole or a part of the patented product which corresponds to the essential part of the patented invention (Second Category).<sup>48</sup>

As for the relationship between the First Category and the Second Category, the IP High Court held as follows: “Whether the accused activity falls within the First Category will be determined in terms of the patented product. On the other hand, whether the accused activity falls within the Second Category will be determined in terms of the patented invention.”<sup>49</sup>

With regard to the First Category, the IP High Court explained that whether “its function has been depleted” should be determined from a social or economic viewpoint.<sup>50</sup> In this regard, the IP High Court listed two scenarios: (a) a scenario where the product has become impossible to use due to abrasion or deterioration under the proper usage, and (b) when the number or duration of use of the product is limited due to hygienic reasons, a scenario where the maximum number or duration of use has been reached, even if the product is still physically or chemically usable.<sup>51</sup> As for the

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<sup>48</sup> Chiteki Zaisan Kōtō Saibansho [Intellectual Prop. High Ct.] Jan. 31, 2006, Hei 17 (ne) no. 10021, 1922 Hanrei Jihō [Hanji] 30, 47-48 (Japan).

<sup>49</sup> *Id.* at 47.

<sup>50</sup> *Id.* at 48.

<sup>51</sup> *Id.*

Second Category, the IP High Court defined “the essential part” as the characteristic part of the claimed structure which is the core of the technical idea and base for a means to solve the problem.<sup>52</sup>

The IP High Court concluded that the accused activity at issue did not fall into the First Category because the function of the ink cartridge was not depleted even if the original ink was consumed, but did fall into the Second Category because refilling the used ink tank constituted processing or replacing the part of the patented products which corresponded to the essential part of the patented invention.<sup>53</sup>

### 3. Holding of the Supreme Court

The Supreme Court upheld the conclusion of the IP High Court; however, it did so using a different rationale. In making a determination whether a patent right is exhausted when a patented product has been wholly or partially processed or replaced, the Supreme Court adopted what Professor Yokoyama calls a “manufacturing approach”:

Enforcement of the patent right is restricted by its exhaustion as far as a patented product which has been transferred by the patentee in Japan is concerned. Therefore, if a patented product transferred by the patentee in Japan is processed or partially replaced, and by those actions it is recognized that a non-identical patented product is freshly manufactured, the patentee should have the right to enforce the patent right with regard to the freshly manufactured product. Whether an act of freshly manufacturing is found should be decided by taking comprehensive account of such factors as attributes of the patented products, contents of the patented invention, details of processing and replacing elements, and actual transactions. For considering the attributes of the patented products,

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<sup>52</sup> *Id.*

<sup>53</sup> *Id.* at 54-58.

the function, structure, material, intended-purpose, useful life span and use mode of the product can be listed as elements to consider in making a determination. For the details of processing and replacing elements, the condition of the product when it was processed, the degree and contents of processing, the period of endurance of the replaced element, technical function and economic value of the replaced element in the product can be enumerated.<sup>54</sup>

## II. DISCUSSION

As explained above, based on the rationales stated in the *BBS* case and the relevant article of the Patent Act, each district court has established clear standards since 1988 with regard to the issue of domestic exhaustion when patented products are wholly or partially processed or replaced. First, the *Konica* court used a standard of whether the accused activity is outside the scope of activity foreseen by the right holder in accordance with social convention as of the assignment of the patented product. Second, the *Fujifilm* court used a two-prong test: (i) whether the function of the product has been depleted; or (ii) whether a third person has replaced an element of the patented product which corresponds to the essential part of the patented invention. Third, the *Hammer* court and *Aciclovir* courts used a standard that determined whether the accused activity constitutes permissible repairing or impermissible manufacturing. Although the individual courts have each established clear and concrete standards, the diverse standards applied have diminished the foreseeability of case outcomes. Consequently, litigation outcomes, and thus the legal strategies applied by attorneys, vary depending on the standards utilized by a particular court.

A patent lawsuit may cause serious economic damages to a defeated party in Japan. If the accused party's activity is found to have infringed a patent right, the damage amount could be

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<sup>54</sup> Saikō Saibansho [Sup. Ct.] Nov. 8, 2007, Hei 18 (ju) no. 826, 1990 Hanrei Jihō [Hanji] 3, 8 (Japan).

enormous and the business activity might be prevented by injunction, which could also have a significant effect on the company. Therefore, in the patent field, it is vital for businesses to ensure predictability and avoid patent infringement. Predictability in this area of the law is vital for economic growth of Japan as well.

The clear standards formed by the courts are favorable not only to business people, but also to Japan. However, the variety of legal standards used by the courts may undermine the legal predictability in a civil law country like Japan. In common law countries such as the United States, where the principle of *stare decisis* exists, the courts have the ability to create laws by dealing with disputes. In the United States, judges are obliged to follow precedent, and the problem of diversified standards may be avoided to some extent. On the other hand, in a country like Japan, where there is no *stare decisis* principle, if the courts try to establish clear standards that can be applied to subsequent cases, the lack of *stare decisis* may create too many independent standards which will diminish foreseeability and credibility of the judicial decisions.

This dilemma was recognized by the Japanese Government, which considers legal predictability in the patent field to be important and has taken several actions to fix this situation. First, the number of courts that have jurisdiction over patent lawsuits has been reduced. In 1999, the Justice System Reform Council was established under the Cabinet for the purposes of “clarifying the role to be played by justice in Japanese society in the 21st century . . . as well as improvements in the infrastructure of that system” and submitted “Recommendations” to the Cabinet in 2001.<sup>55</sup> In the Recommendations, the Council proposed “to make the specialized departments at both Tokyo and Osaka District Courts function substantially as ‘patent courts,’ the specialized processing system of these courts should be further reinforced by . . . the granting to the Tokyo and Osaka District Courts of exclusive jurisdiction for cases related to patent rights . . . etc.”<sup>56</sup> In

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<sup>55</sup> *Shihōseido kaikakushingikai* [the Justice System Reform Council], Recommendations of the Justice System Reform Council (Jun. 12, 2001), available at <http://www.kantei.go.jp/foreign/judiciary/2001/0612report.html>.

<sup>56</sup> *Id.*

accordance with the Law for Partial Amendment of the Code of Civil Procedure which came into effect in 2004 to ensure this proposal, the Tokyo District Court and Osaka District Court came to have exclusive jurisdiction over actions relating to patent rights at a district court level, and the Tokyo High Court came to have exclusive jurisdiction over such actions at a high court level.<sup>57</sup> More specifically, only four divisions in the Tokyo District Court, two divisions in the Osaka District Court, and four divisions in the Tokyo High Court deal with such actions as divisions specialized in IP cases.<sup>58</sup> This reduced the opportunity for issuance of diverse patent law standards.

Moreover, to restore the international competitiveness of Japanese industry, and to create, protect, and use intellectual property for revitalizing the economy, the Intellectual Property Policy Headquarters was created in the Cabinet in 2003; the Headquarters designed the “Strategic Program for the Creation, Protection and Exploitation of Intellectual Property” in July of 2003.<sup>59</sup> This Strategic Program described CAFC as a court established “for the principal purpose of rendering consistent judgments” and mentioned that “[CAFC] solidified rights and improved the predictability of judgments, thereby contributing to a pro-patent business approach.”<sup>60</sup> Further, the Strategic Program proposed the establishment of the IP High Court “[f]rom the viewpoint of strengthening the competitiveness of intellectual property, which is decisively important for the Japanese economy to maintain its global edge, and in order to emphasize the intellectual property-oriented national policy both inside and outside of Japan. . . .”<sup>61</sup> These descriptions show that the Japanese Government had the same awareness as Judge Rader.

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<sup>57</sup> Minji soshōhō [Minsohō] [C. Civ. Pro.] art. 6, paras. 1, 3 (amended 2003) (Japan).

<sup>58</sup> *History, INTELL. PROP. HIGH CT.*, (2005), available at <http://www.ip.courts.go.jp/eng/aboutus/history.html> (last visited May 9, 2012).

<sup>59</sup> *Chitekizaisan Senryakuhonbu* [Intellectual Property Policy Headquarters], Strategic Program for the Creation, Protection and Exploitation of Intellectual Property (Jul. 8, 2003), available at [http://www.kantei.go.jp/foreign/policy/titeki/kettei/030708f\\_e.html](http://www.kantei.go.jp/foreign/policy/titeki/kettei/030708f_e.html).

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

Subsequently, the IP High Court was established in 2005, as a special branch within the Tokyo High Court.

Furthermore, the Grand Panel system was introduced in 2004 to the Tokyo High Court for actions relating to, among other subjects, patent rights, in order “to form reliable rules and ensure consistency of judicial decisions at a high court level.”<sup>62</sup> In this system, a five-judge panel hears a case instead of only three judges that hear cases in a regular panel.<sup>63</sup> Although not all judges of the IP High Court hear every case using the Grand Panel system, “the decisions [of the Grand Panel] are, in practice, based on discussions by the whole court.”<sup>64</sup> Through the Grand Panel system, the problem where there are too many standards presented by several courts, including the district court as well as the regular panel of the IP High Court, may be resolved at a high court level by unifying the standards. To the extent that it has become possible to ensure consistency of judicial decisions at a high court level, the function of the Grand Panel system is the same as that of an en banc system in the CAFC<sup>65</sup>.

With regard to the issue of domestic exhaustion when patented products are wholly or partially processed or replaced, in 2006 the Grand Panel of the IP High Court standardized the various rules that the district courts and the regular panel of the high court had been presenting since 1988. Although the Supreme Court took a different position from the IP High Court,<sup>66</sup> the Japanese Government’s efforts to ensure the same ideas of Judge Rader’s thoughts bore fruit after more than 10 years. Practically speaking, a unique system combining aspects of both a common law system

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<sup>62</sup> *Current Status*, INTELL. PROP. HIGH CT., (Mar. 2010), available at <http://www.ip.courts.go.jp/eng/aboutus/current.html>.

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> Please note that unlike a decision of an en banc court, judges of the IP High Court cannot write a dissenting opinion in the decision of the Grand Panel. Thus, we cannot see from the decision whether there is any judge who disagrees with the decision of the Grand Panel.

<sup>66</sup> The tendency of the Supreme Court to replace a concrete standard made by an appellate court with a more general standard is often found not only in Japan, but also in the United States.

and a traditional civil law system is being formed in the patent field in Japan.

#### CONCLUSION

Japanese courts seem to make an effort to present a clear and concrete rule in patent law cases, as seen in their holdings in the field of patent exhaustion theory. This inclination of Japanese courts is parallel to Judge Rader's view where businesses need clear patent law jurisprudence. Such a tendency in a civil-law country like Japan has caused a critical problem, i.e., too many independent standards, which would not likely be posed in a common law country. Japan dealt with this problem by reducing the number of courts that have jurisdiction over patent lawsuits, establishing the IP High Court, and introducing the Grand Panel system to the IP High Court. Through such measures, it has become possible for the Japanese courts to establish clear standards without diminishing foreseeability too much and help settle and prevent possible disputes. In this way, the courts in Japan have enhanced credibility of the judicial decisions in the patent field.