

## Exhaustion of IP Rights in Japan

(Part 1)

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### Forewords

In this series of articles, Parts 1 and 2, issues related to repair and remanufacturing of products protected by intellectual property rights will be discussed. In Part 1, patent exhaustion is discussed. In Part 2, the other areas of intellectual property laws such as trademark, unfair competition, design and copyright laws will be discussed in a subsequent issue with some short remarks about recycling in general in Japan discussed at the end.

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## 1. Patent

### Patent Exhaustion in Japan

#### A. Introduction

The exhaustion of a patent is a well-established concept in Japan while no statutory provisions exist. The Supreme Court of Japan has two notable decisions involving patent exhaustion: one related to the recycling of ink cartridges for ink-jet printers, and the other related to the parallel importation of high-end automobile wheels from Germany for which corresponding patents existed in Japan and Germany. The German company called BBS originally made and sold patented products and wanted to stop the parallel importation of its products into Japan from Germany based on its Japanese patent.

There are several interesting decisions from Japanese courts, which will also be discussed.

When recent court decisions are analyzed as can be seen below, two fact patterns emerge in which a patent does not exhaust. These two patterns or categories are referred to as "effectiveness (utility) category" and "remanufacturing category". If "the patented article is reused or recycled after completing its normal life and losing its effectiveness or utility as a product," the patentee can enforce his patent against further use of such product. Also, if "a part of the article constituting an essential part of the patented invention is partly or completely modified or replaced by a third party," the

patentee is allowed to enforce his patent against the remanufactured article. These two categories correspond to Categories 1 and 2 discussed in the Canon Ink Tank Case before the Grand Panel at the Intellectual Property High Court, which is discussed below. According to the language used in the Supreme Court decision in the same Ink Tank Case, the distinction between Categories 1 and 2 is somewhat blurred, but the Supreme Court did not say that such classification using Categories 1 and 2 is unacceptable, either.

## B. Ink cartridge case - "Canon Ink Tank Case"

This case was decided by the Supreme Court on November 8, 2007 (Case No. 2006(ju)826). The plaintiff was Canon Inc., which had a Japanese patent covering its own ink cartridge design, and the defendant was a company that collected used ink cartridges, had them cleaned and refilled with new ink outside Japan, and sold the refilled cartridges in Japan.

### (i) The Intellectual Property High Court decision in 2006

The case went before the Grand Panel of the IP High Court on appeal from the Tokyo District Court.<sup>1</sup> The IP High Court decided, using its own discretionary power, to hear the case before the so-called Grand Panel, which consists of the four chief judges of its four divisions plus another less senior judge, as opposed to a regular panel of three judges in one division. The IP High Court denied a notion that focuses on the classification of permissible repair and impermissible manufacture. Specifically, the IP High Court determined that a patent does not exhaust and the patent is thus enforceable with regard to the patented article under the following categories:

- (i) when the patented article is reused or recycled after completing its normal life and losing its effectiveness or utility as a product (Category 1); or

- (ii) when a part of the article constituting an essential part of the patented invention is partly or completely modified or replaced by a third party (Category 2).

As for the relationship between Categories 1 and 2, the IP High Court held as follows: "Whether the accused activity falls within Category 1 will be determined in terms of the nature of the patented article. On the other hand, whether the accused activity falls within Category 2 will be determined in terms of nature of the patented invention."

As regards Category 1, the IP High Court explained that whether "losing its effectiveness or utility" should be determined from a social or economic viewpoint. For the effectiveness to be lost, the IP High Court listed two scenarios: (a) when the article has become impossible to use due to abrasion or deterioration under the proper usage, or due to when the number or duration of uses of the product is limited due to chemical changes in the composition of the product, (b) when the number or duration of uses is restricted because of hygienic reasons, even if the product (such as a disposable syringe or a medicine) is still physically or chemically usable beyond the restricted number or duration. As to Category 1 and scenario (a), even if consumables, such as batteries or filters, or parts which have shorter life, such as electric bulbs, packings or seals, are replaced due to damages, if such replacement belongs to the category of repair, the effectiveness of the product is not considered finished. On the other hand, if major components of the product are greatly modified or replaced, or if most of the parts are replaced, the expected lifespan of the product is unduly extended beyond the category of repair discussed above, and the effectiveness of the product is considered finished at the time of such modification or replacement. The court noted that these circumstances should be considered in *toto* in terms of the product itself, and not from a technical viewpoint of the patented invention. Also,

with respect to scenario (b) above, even if the patentee somehow tries to limit the use of the ink cartridge by way of notice to users, such restriction does not have anything to do with the doctrine of exhaustion because the restriction as to usage does not have a legal basis nor a solid base in common understanding in the society.

As regards Category 2, the IP High Court defined “the essential part” as the characteristic part of the claimed structure or constitution which forms the core of the technical idea and the means for solving the problem. This is because a patent is granted to protect the core value of an invention in exchange for disclosure of specific structures or features of the invention.

The IP High Court concluded that the accused acts did not fall into Category 1 because the ink cartridge had not lost its effectiveness or utility even if the original ink was entirely consumed and there are no social or legal basis to say that the ink cartridge could be used only with initially supplied ink. The accused acts, however, did fall under Category 2 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. In other words, the patented functionality of preventing any leakage of ink when the cartridge is handled by a user, which is realized by the claimed features, is lost when the ink is consumed, and recreated by cleaning the used cartridge and refilling it with new ink because ink itself function as an essential component in cooperation with other claimed features to prevent ink leakage.

## (ii) Decision by the Supreme Court of Japan in 2007

The Supreme Court noted as follows (underlines are as provided in the decision):

Exhaustion restricts the enforcement of a patent only for a specific article itself

sold by the patentee in Japan. Therefore, when an article sold in Japan by the patentee is modified or its parts are replaced, and thus a patented article having an identity that is different from that of the patented article is considered to have been created, the patentee should be permitted to enforce the patent with respect to the new article. Moreover, in order to determine whether a patented article is newly constructed, it is appropriate to consider the totality of the circumstances including the attributes of the patented article, the details of the patented invention, the manner in which the article has been modified or its parts replaced, as well as the actual manner of the transaction, etc. The attributes of the patented article should include the article's functions, structure and materials, intended uses, lifespan, and the manner in which it is used. The manner in which the article has been modified or its parts have been replaced should include the state of the patented article when it is modified, the nature and degree of the modification, etc., the lifespan of the replaced parts, and the technical function and economic value of those parts within the article.

The Supreme Court applied the above principles and concluded that Defendant's accused acts amounted to new creation of patented articles. In essence, the Supreme Court rejected the categorical approach the IP High Court took and adopted a more general approach, but reached the same conclusion.

## C. BBS Aluminum Wheel Case in 1997

The Supreme Court of Japan rendered a decision on July 1, 1997 in case No. 1995(o)1988 in so-called BBS aluminum wheel case. The Supreme Court reasoned that the free flow of products is expected among those who buy products regardless of whether patented or not, and such expectation should be honored and

should not be stopped by a patent. This is equally applicable to domestic and international trade. Then, the Supreme Court concluded as follows:

[I]f the owner of a patent in Japan, or a person who can be recognized as an entity identical to the patent owner, sells its patented products outside Japan, a reasonable interpretation is that the patentee should not be allowed to enforce its patent in Japan against the buyer unless the buyer explicitly agrees to exclude Japan from the place of sale or use and against a third party or subsequent buyers who purchases the patented products from the buyer, unless a notice of such agreement is clearly placed on the patented products.

The Supreme Court based its conclusion as follows:

- (i) The protection of an invention under the Patent Act has to be achieved in harmony with public interest.
- (ii) In general, through the act of sale, all rights attached to the products are transferred to the buyer. The buyer receives all rights the seller owns. When a patented product is placed on the market, the buyer enters into a deal with a presumption that he would obtain rights to freely use and resell the product as a business. If the sale of the patented product requires approval from the patentee for each transaction, the free flow of the product in the market would be interrupted and the smooth distribution of the patented product would be disturbed. This would cause adverse effects on the patentee's interests and would be contrary to the purpose of the Patent Act, which aims at encouraging inventions by "promoting their protection and utilization so as to contribute to the development of industry" (see Article 1 of the Patent Act).

- (iii) On the other hand, a patentee receives proceeds including a reward for disclosing its patented invention when the patentee sells its patented product. When it licenses the patent, it receives royalty payments. It can be said that an opportunity to secure a reward for disclosing its patented invention is guaranteed. Thus, once the patentee or its licensee sells patented products, there is no need to allow the patentee to obtain double profits through the process of distribution.

These basic understandings of the patent system have underpinned subsequent lower court decisions.

## D. Konica single-use camera case - decided in June 2000

In the Konica case,<sup>2</sup> the defendant was accused of refilling the plastic housing of used single-use cameras - products that were covered by utility model and design registrations - with new film and batteries and selling the refurbished products. 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 would obtain the rights to use and reassign the product without being accused of infringement.

Judging from the objective nature of the product, the character of the transaction, and the manner of use in accordance with social convention, if it cannot be understood that the right holder granted the assignee unqualified rights to use and reassign the assigned product free from being accused



of infringement, the right holder may exercise his right against activities beyond the qualified scope of activities.

The district court found that because the products at issue were single-use cameras in which only the pre-equipped film was supposed to be used, the accused acts were considered to go beyond the scope of activity foreseen by the right holder at the time of the initial sale. The district court concluded that the utility model right and the design right had not been exhausted.

### **E. Fujifilm single-use camera case - decided in August 2000**

This case<sup>3</sup> also relates to a patent on single-use cameras and the fact patterns were almost the same as in the above Konica case. Fujifilm Corp. asserted one patent, three utility model registrations and three design registrations. 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 would obtain the rights to use and reassign the product without being accused of infringement. The district court further held that the "rights to use and reassign" are transferred to the assignee on the presumption that the effectiveness of the product still remains. In other words, a patent may be enforceable after the effectiveness of the patented product - single-use of the camera - is finished because once the effectiveness is gone, the product is not expected to be further used or reassigned. Also, the patentee would not receive double profits from the patented product through exercising his right once the effectiveness of the product is gone.

In this particular case, the plaintiff's products have been sold as disposable cameras since their first sale in 1987. A consumer who buys the disposable camera or film unit, once he or she uses up the film contained in the camera, brings the whole camera to a shop and ask for development and prints. The consumer receives

only a developed film and prints, not the camera body or film unit. Since large number of such products have been sold (50 million units in 1997) and it had become a common understanding in the society that camera bodies are not returned to consumers by the time defendants started their sales in 1994. Thus, the plaintiff's products finished their effectiveness when films are taken out at film developing laboratories. Therefore, any of the patent and other rights did not exhaust domestically or internationally, and the plaintiff is allowed to enforce its rights in question.

Furthermore, the district court proposed another situation in which a patent would not exhaust by hypothesizing a situation where a third party replaces an element of a patented product that corresponds to the essential part of the patented invention.

The Tokyo District Court found patent infringement.

### **F. Aciclovir case**

Glaxo was the exclusive licensee for a Japanese patent (No. 1090820) on aciclovir - an anti-virus drug. Sawai, a generics maker in Japan, bought the Glaxo's drug product containing acyclovir on the market. It then made its own drug product and sold it at a price lower than that of the Glaxo product because it was obligated to sell such drug. All these occurred during the extended term of the patent.

The Tokyo District<sup>4</sup> Court used the same reasoning as in the Fujifilm case, i.e., that domestic exhaustion is denied when: (1) the patented product is reused after the effectiveness or utility of the patented product is finished; or (2) an element of the patented product corresponding to an essential part of the patented invention is replaced. The district court concluded that the patent at issue exhausted because the situation in this case did not fall into either category.

The Tokyo High Court<sup>5</sup> upheld the conclusion of the district court on somewhat different grounds. The court explained that a patent exhausts with respect to the defendant's such activities as use and sale of the aciclovir Glaxo sold, but it may not exhaust with respect to the defendant's manufacturing activity. If the defendant's activity is evaluated as the manufacture of a new product, it would constitute an act of infringement.

Replacing an element of a patented product which corresponds to the essential part of the patented invention is typically recognized [as manufacture.] ... Whether an act of processing the patented product falls within the scope of mere repair or constitutes the manufacture of a new product is determined based on the structure and working effects or technical idea of the patented invention. In other words, we should determine, by judging from the nature of the product and the manner of use of the product, whether the alleged act constitutes the manufacture of a new product, or whether it does not change the identity of the original patented product, such as an act of repairing in order to fulfill the lifetime of the product.

The Tokyo High Court found that Sawai did not cause any chemical reaction to the aciclovir, nor Sawai produced any new aciclovir by some chemical reaction. Accordingly, the court held that the Sawai did not manufacture aciclovir, and therefore Glaxo was not allowed to enforce the patent against Sawai.

## G. Fujifilm single-use camera case No. 2

Fujifilm Corp. asserted two patents against two Japanese companies that imported and sold in Japan Fujifilm's single-use cameras that were refurbished outside Japan.<sup>6</sup> Since this case was decided prior to the Supreme Court decision in the Canon Ink Tank case, the Tokyo District Court

relied on the Grand Panel decision of the IP High Court. The TDC found that the fact pattern in this case falls under Category 2 of the Grand Panel decision (replacement or modification of the whole or a part of a member that constitutes the characteristic portion which forms the essential portion of the patented invention or the core of the patented technical idea in the patented product by a third party), and concluded that the defendant's acts amounted to the manufacture of new products.

## H. Canon Cases

Since the Supreme Court decision discussed above, Canon sued a variety of companies that sold compatible ink cartridges and won in most cases.<sup>7</sup> The defendants asserted patent exhaustion as a defense, but these cases relate to importation and sale in Japan of ink cartridges manufactured abroad, and have nothing to do with recycling of ink cartridges. Therefore, nothing new or important is found in these decisions.

## I. Roll Paper for Packaging Prescription Drugs Case<sup>8</sup>

The plaintiff in this case asserted a patent covering special roll paper and two trademark registrations covering its own corporate name against the defendant. The product in dispute was roll paper used for packaging powder or tablet drugs at pharmacies for individual doses in accordance with prescriptions issued by doctors. The roll paper and its core had a magnet so that the rotation could be monitored. The plaintiff made and sold machines for such packaging and also sold paper rolls used for its machines. The defendant collected cores of the paper rolls from pharmacies and wound new paper over the cores for sale to pharmacies. The defendant's paper rolls could be used only on the plaintiff's machines. Because the defendant used, without any modifications, the

cores of the plaintiff's roll paper, the defendant's products had the plaintiff's trademark on the cores.

The Osaka District Court noted that the plaintiff's patent did not exhaust against the defendant's products on two grounds.

First, the plaintiff had made it clear that the ownership of its cores remain with the plaintiff. The cores were simply on loan without any charges from the plaintiff. The plaintiff made this clear on its products and packaging materials as well as in its advertisement. Also, more than 97% of the cores had been returned to the plaintiff from 2010 to August 2012, and this fact indicated that not only final customers such as hospitals and pharmacies, but also dealers had well recognized the plaintiff's ownership. Since paper was completely consumed by customers and the ownership of the cores remained with the plaintiff, no basis was found for patent exhaustion.

Secondly, the court noted that even if the question of ownership is set aside, identity could not be found between the defendant's and plaintiff's products. Quoting the Canon Ink Tank Supreme Court decision, the court noted that the patentee is allowed to enforce its patent if patented products sold by the patentee or an authorized party are modified or their parts are replaced to the extent that it is recognized that new products which lack identity with the original patented products are manufactured. The plaintiff's products lost effectiveness or utility when paper was consumed while cores had a much longer life. The value associated with the products was in paper, not cores, because pharmacies could never be able to wind specialized paper on the cores, and the effectiveness or utility of the patented products is finished when paper is consumed. The defendant's acts were considered as the manufacture of new products, against which the patent does not exhaust.

Also, the court rejected the defendant's argument of exhaustion of the trademark rights with respect to the original trademark found on the core. The defendant's acts constituted trademark infringement.

## J. Apple v. Samsung FRAND Case

The huge global patent battle between Apple Inc. and Samsung Electronics has left notable traces in Japan as well.<sup>9</sup> In the Grand Panel decision of the IP High Court<sup>10</sup>, in which the IP High Court superficially sided with Samsung and awarded about US\$100,000 of damages to it, the court had some lengthy discussions on patent exhaustion. Apple argued that Samsung's patent in dispute exhausted under the license between Samsung and Intel, under which Samsung had been allowed to manufacture baseband chips. Such baseband chips were incorporated into Apple's smart phones. This license expired some time ago, but for the purpose of arguments, the IP High Court assumed that the license was still valid, and concluded that the patent did not exhaust under the specific fact pattern in this case.

It is unlikely that this decision, which based arguments on the two Supreme Court decisions mentioned above, sheds any new light on the issues discussed here, and provides no further details.

### Notes:

- 1) Decided on Jan. 31, 2006, case No.2005(ne)10021
- 2) Tokyo District Court, June 6,2000, case No.1999(yo)22179 (preliminary injunction case)
- 3) Tokyo District Court, Aug. 31, 2000, case No.1996(wa)16782
- 4) Tokyo District Court, January 18, 2001, case No.1999(wa)27944
- 5) Tokyo High Court, November 29, 2001, case No.2001(ne)959
- 6) Tokyo District Court, April 24, 2007, case No.2005(wa)15327
- 7) To mention only one case, a Tokyo District Court case against K.K. Sap, et al., decided on June 24, 2010, case Nos. 2009 (wa)3527, etc.
- 8) Yuyama Manufacturing Co., Ltd. v. Nissin Medical Industries, Co., Ltd., Osaka District Court, January 16, 2015, case No. 2012(wa)0871
- 9) Now all Japanese lawsuits between Apple and Samsung ended with settlement.
- 10) The Grand Panel of the IP High Court, May 16, 2014, case No. 2013(ne)10043

*To be continued in the next issue*