6 Legal Issues Concerning the Use of Trusts for Intellectual Property

Presently, when intellectual property rights (IPRs) are managed and utilized within a business group or when technologies are transferred from universities to the private sector, the rights are managed in a centralized manner by way of transfer or commission. However, centralized management through these methods involves various potential managerial problems.

On the other hand, centralized management by trust, which is positioned between the transfer method and the commission method, is a potential method for enjoying advantages of both methods.

This report particularly focuses on patent rights and rights to obtain patents among IPRs, and based on the assumption that these rights are to be centrally managed by the trust method, analyzes the eligibility of these rights as trust property, the issues under the Trust Law such as the relationship between the trustor and trustee, the taxation and accounting treatments related to trusts, and the significance of the trust method. This report also provides results of the investigation on the trends of use of the trust method in Europe and the United States.

Ⅰ Current Status of the Centralized Management of IPRs

This chapter presents actual cases of the centralized management of IPRs in business groups and TLOs, where such management is strongly desired, and clarifies issues found in these cases while providing examples of the centralized management of copyrights with the use of trusts, thereby considering the possibility to apply the trust method to the centralized management of patent rights and other IPRs.

1 Centralized Management of Patents and Other IPRs in Business Groups

One of the effective measures for companies that belong to a business group to respond to changes in the business environment while carrying out their business activities may be reorganization of member companies within the group. However, if the transfer of IPRs frequently occurs within the group whenever such reorganization is conducted, that would impose significant costs on the member companies.

Such awareness seems to create needs for the centralized management of IPRs by a parent company that has an IP management department or by an IP management company within the group. There are two types of centralized management: the transfer method in which the ownership and the management functions of rights are concentrated to the IP management company or department, and the commission method in which the ownership of rights belong to individual subsidiaries while the management functions are concentrated to the IP management company or department.

The transfer method seems to be efficient and effective in carrying out IP-related operations as well as human resource development. However, it also has the following potential problems:

① It is uncertain whether centralized management would be realized in an optimal manner for the business group as a whole;

② Cumbersome evaluation work would be required for the transfer of rights;

③ Risks would need to be taken when providing compensation for employees' inventions made in subsidiaries;

④ Costs would be incurred when subsidiaries transfer their IPRs to the IP management company or department.

The commission method, on the other hand, is also effective from the perspective of operational efficiency. Furthermore, in this method, as individual subsidiaries can retain their own patent rights, it is expected that such subsidiaries would easily understand the importance of strategic creation of inventions and maintain their incentives for such creation. However, potential problems also exist with this method:

① It is not clear whether the IP management company or department would be allowed to engage in obtaining patent rights for inventions made in the subsidiaries and negotiating licensing contracts or filing a representative suit as a conventional agent in the disputes over infringement of patent rights;

② It would be difficult for the IP company or department to handle IPRs under the strategy for the business group as a whole due to being constrained by subsidiaries' intentions.

2 Centralized Management of Inventions Made by Universities at TLOs

TLOs are engaged in various activities such as

discovering, evaluating and selecting specific research results that can be commercialized, providing information on specific research results, licensing patents to private businesses, returning licensing fees and revenues to researchers, providing management advice, technical instructions and financial support to universities, and carrying out other activities necessary for efficient transfer of specific research results. However, they also have various potential problems concerning: ① how to encourage university researchers to maintain their incentive for creation under the transfer method, how to return patented inventions to the researchers who created them and how to cope with tax risks arising from the transfer of rights; ② how to obtain credit from private companies that are potential licensees under sublicense contracts; and ③ how to reduce the burden on researchers under the commission method.

3 Centralized Management of Copyrights

The Law on Intermediary Business Concerning Copyrights of 1939 defined an "intermediary business" as an act of agency or mediation on behalf of copyright owners regarding contracts for the use of their works for publication, broadcasting, cinematographing or other uses. This law also deemed "obtain[ing] the transfer of copyrights" to perform, as an occupation, an act of managing the copyrighted works in pursuance of a specific object on behalf of other persons as an "intermediary business" concerning copyrights Section 1(1) and (2)). "Transfer of copyrights" in this provision shall constitute a deed of trust. The government was actively involved in these types of "intermediary business" (management business): Any person who intended to engage in intermediary business had to obtain the "permission" of the Commissioner of the Agency of Cultural Affairs and such person had to also obtain the "approval" of the Commissioner to specify rules relating to the royalty rates for the use of the works.

In 2001, the Law on Intermediary Business Concerning Copyrights was repealed and the Law on Management Business of Copyrights and Neighboring Rights (hereinafter referred to as the "Law on Management Business of Copyrights") was enacted. Under the new law, joint-stock companies are also allowed to engage in the copyright management business in addition to public corporations and other associations similar to them.

In relation to the Trust Business Law, Section 26 of the Law on Management Business of Copyrights provides that ① the provisions of Section 1 and 2 of the Trust Business Law shall not apply to persons who engage in the trust business that deals with only copyright, etc. under a trust contract and ② trust companies or banks or other financial institutions conducting trust businesses may also accept the trust business that deals with copyright, etc. under a trust contract. In these provisions, "trust [business]" is intended to conduct management of rights, which is one of the applications of trust business under the Trust Law but is actually governed by the Law on Management Business of Copyrights rather than the Trust Law in Japan.

4 Toward the Centralized Management of Patent Rights and Other IPRs with the Use of Trusts

Since the Law on Management Business of Copyrights was established, the scope of copyrighted works to be managed by trust has been expanded significantly. Nevertheless, most copyrights that are currently handled in centralized management are music copyrights, which were covered by the Law on Intermediary Business Concerning Copyrights.

Though music copyrights and patent rights are the same in the sense that both are rights over products resulting from creative activities by human beings, there seems to be a significant difference between them in terms of the stability of rights.

A music copyright comes into force when the music work is created without any formality requirements. On the other hand, in the process from completing an invention to obtaining a patent right, it is necessary to file an application to the JPO and go through examination. Furthermore, even after a patent right came into force, it may be invalidated due to an opposition to the grant of patent or a demand for invalidation trial. Since the Supreme Court judgment on the Kilby Patent was rendered, in particular, the validity of patent rights has often been examined in infringement lawsuits. As a result, it seems very difficult to judge the validity of patent rights in advance, and a patent right contains unstable factors in comparison with a music copyright.

In some cases of technology transfer through TLOs, creative products other than patented inventions, such as technical know-how, are extremely important and therefore should normally be transferred along with patented inventions. There will be needs for the management of such technical know-how as trust property in combination with patent rights. It is also possible to legally protect technical know-how other than patented inventions by protecting it as "trade secrets" under the Unfair Competition Prevention Law. In this case, it is necessary to consider whether trade secrets can be included in trust property.

In considering whether centralized management through trust-based transfer, which is currently applied mainly to the management of copyrights, can also be applied to the management of patent rights and other IPRs in business groups and TLOs, it is necessary to examine the eligibility of such rights as trust property, how to handle technical know-how (trade secrets) relating to patented inventions, and the roles and functions of the trustee.

Ⅱ Centralized Management of IPRs by Trust and Issues to Be Considered

Where a trust is used for the centralized management of IPRs in a business group or TLO, subsidiaries within the business group or universities (researchers) involved in the TLO can, as the trustors, retain the authority to supervise license contracts while obtaining profits and achieving the intended management and disposal of rights. Furthermore, as the rights themselves are transferred under the provisions of the Trust Law, the legal relations arising from the use of such rights will be very clear.

This chapter overviews the legal problems that are likely to arise from the centralized management of IPRs by trust. The arguments in this chapter and subsequent chapters focus on patent rights in particular among the IPRs.

1 Relevance with the Existing Trust-Related Laws

The Trust Law and the Trust Business Law constitute the core of the Japanese trust system. Article 4 of the Trust Business Law limits the types of property that may be accepted by a trust company to ① money, ② money claims, ③ personal property, ④ land and objects firmly affixed to land, ⑤ superficies, and ⑥ lease of land. Under the existing provision, IPRs may not be handled in the trust business except for trusts concerning copyrights, etc. under the Law on Management Business of Copyrights, which is a special law for the Trust Business Law. However, it is actually pointed out that how to reduce the cost for the management of IPRs is a big problem in current corporate management and that the limitation of trust property in Section 4 of the Trust Business Law does not fit the needs for diversification of financing means. Thus, there is a growing call for the abolition of the limitation.

The Patent Registration Order provides that patent rights may be registered by a trustee. Accordingly, within the framework of the existing law, such trustee registration of patent rights may be allowed if it is conducted not by a trust company that is engaged in the trust business but by a parent company of a business group for the perspective of concentrated management. However, this method may not be applied in the course of commercial trusts and therefore it is hardly utilized in the present situation.

Furthermore, for the purpose of promoting securitization of IPRs, it is theoretically possible within the framework of the existing law to establish a special-purpose trust for such rights under the Law on Securitization of Assets. However, as strict requirements should be satisfied for establishing such trust, this method is also hardly utilized in reality.

2 Eligibility of Right to Obtain a Patent, Patent Right and Know-How as Trust Property

The Trust Law seems to stipulate four requirements for property rights to be generally considered as trust property: ① being convertible into money; ② being positive property; ③ being transferable and disposable; and ④ being in existence and specific in nature.

Convertibility into money means that trust property has monetary value and is able to be assessed in monetary terms. Since a “patent right” is a property right that can be handled in transactions or mortgages, it can theoretically be assessed in monetary terms and therefore be included in the scope of “trust property.” Similarly, a “right to obtain a patent” can also be included in the scope of “trust property” as it also has characteristics of a property right and can theoretically be assessed in monetary terms. Though it is somewhat difficult to evaluate a “right to obtain a patent” and a “patent right” to convert them into money, the problem of doing so is merely a practical one and would not be a legal obstacle when establishing a trust for these rights. On the other hand, “know-how” serves as valuable “property” in the actual economy and society, as does a “right to obtain a patent”. In reality, know-how is transferred or licensed to a third party, and it is even used as investment in kind in the case of establishing a joint-stock company or issuing new stock. Considering such ability to be used as investment in kind, know-how also seems to be “convertible into money” in the same way as is a patent right.

Positive property refers to claims, as opposed to negative property such as debts. Article 1 of the Trust Law limits the subject in trust to “property right,” which seems to refer to positive property. In light of this, a trust may not be established only with respect to negative property or with respect to a combination of positive property and negative property.

Both a “right to obtain a patent” and a “patent

right" satisfy the requirement of being transferable and disposable, but it should be noted that the scope of a "right to obtain a patent" includes a "right to be mentioned as inventor." "Know-how" also seems to satisfy this requirement because the right to exploit or use know-how can be granted to a third party under a transfer or licensing contract in the same manner as a patent right.

With respect to existence and specificity, a patent right satisfies the requirement of being in existence and specific because it comes into force when its establishment is registered (Section 66 of the Patent Law). On the other hand, a "right to obtain a patent" shall not be effective against a third party unless a patent application is filed (Section 34(2) of the Patent Law). As a result, there is no way to make public and effective a "right to obtain a patent" before the filing of a patent application, which would cause considerable instability in establishing a trust for such right. "Know-how" can be specified by distinguishing particular confidential information as know-how from other information retained by a company. It is also possible to use authentic documents on facts and tests prepared by a notary public (in this case, the exact portion that constitutes know-how is documented and specified.) Thus, know-how also seems to satisfy the requirement of being in existence and specific in order to be included in the scope of trust property.

Considering these eligibility requirements for trust property, it cannot be denied that there is a doubt about the stability of establishing a trust for a "right to obtain a patent" before the filing of a patent application and for "know-how," because they cannot be made public and therefore shall not be effective against a third party. It is necessary to continue detailed discussions on the eligibility for trust property, including the development of means to make such right and know-how effective to a third party.

3 Powers of Trustor

The trustee has, in principle, an exclusive management right to make management decisions with respect to establishing a "right to obtain a patent," maintaining and managing a patent right and carrying out licensing negotiations or lawsuits. In other words, the trustee alone has the power of disposal in the trust relationship whereas the trustor in principle has no power concerning disposal but retains the status of the party to set an objective. However, where the trustor's instruction power is so strong that the trustee's power becomes weaker or extinguished, such a trust would be a passive trust and therefore be invalidated.

4 Eligibility of Trustee

In the current trust business field in Japan, there is no trust company under the Trust Business Law. Therefore, in the case of the centralized management of patent rights by trust, whether a parent company (IP management company) of a business group or a TLO is eligible as trustee will be a major problem. In light of the recent trend of deregulation and taking into consideration the technical knowledge necessary for the centralized management of "rights to obtain patents" or "patent rights," it seems necessary to review the regulations on eligibility as trustee.

Should a trust bank, which is engaged in the current trust business, act as a trustee in a trust for a patent right, the bank is likely to use an expert as an assistant or an attorney under the Trust Law because advanced technical knowledge is required for establishing a right to obtain the patent, maintaining and utilizing the patent right and defending against attacks from a third party.

5 Relationship between the Trustor and the Trustee and the Duties of the Trustee

Section 20 of the Trust Law provides that the trustee shall handle trust property with the care of a good manager (duty of care). The trustee shall also bear the duty of loyalty not to obtain trust property as his own property or act in conflict with the interests of the beneficiary (Section 22), the duty not to delegate but to, in principle, personally conduct trust services (Section 26), the duty of segregation of trust property from his own property or other property (Section 28), and the duty to provide information. These duties are necessary for achieving the centralized management of IPRs as the trustor desires. They constitute the core of the trust and "cannot be deleted."

6 Protection of Trust Property Upon Bankruptcy of the Trustee

The trust relationship terminates when the trustee is declared bankrupt. In this case, since trust property is not included in the trustee's liability property that serves as reserves for debts, the trustor or beneficiary may be allowed to execute the right of resumption, by reason of his ownership of the trust property, against the trustee's bankruptcy administrator. This is called "bankruptcy isolation function" in trust and it seems to be one of major advantages in using a trust for the centralized management of IPRs. Accordingly, licensing contracts concerning "rights to obtain patents" or "patent rights" will continue to be effective even after the trustee is declared bankrupt.

Ⅲ Taxation and Accounting Treatment for the Centralized Management of IPRs by Trust

1 General Principles for Taxation for Trust

One of the major general principles under the tax laws is the principle of taxation on the actual beneficiary. Under the trust system, trust property formally belongs to the trustee but it substantially belongs to the beneficiary. For this reason, under the tax laws, trust property is in principle recognized as belonging to the beneficiary and taxes are imposed on the beneficiary with respect to incomes arising from the trust property.

As for corporation tax, in principle, ① the beneficiary of a trust where it is specified, or ② the trustor of trust property where the beneficiary is not specified or absent, shall be deemed to own the trust property and therefore shall pay corporation tax with respect to incomes and expenditures arising from the trust property.

The same applies to income tax and consumption tax. In principle, the beneficiary or the trustor shall be deemed to own the trust property and therefore shall pay income tax with respect to incomes and expenditures arising from the trust property as well as be subject to the application of the Consumption Tax Law with respect to the transfer of assets that are included in the trust property.

In conclusion, taxation on a trust for the centralized management of IPRs will be neutral and clear, and there will be no detrimental tax treatment in the case where a trust is used for the centralized management of IPRs.

2 Accounting Treatment

In carrying out the accounting for a trust, it is important to consider for whom (e.g. the trustee, beneficiary or trustor) and for what purpose it is to be carried out.

According to the current accounting practices, the accounting procedures are carried out as if the beneficiary (trustor) himself owned trust property, with the trust relationship being deemed as a channel. For this reason, the accounting is processed and disclosed in accordance with the beneficiary's objective for the trust both on the part of the trustee and the beneficiary (trustor).

In the case of centralized management within a business group, consideration should be given to the same treatment as consolidated accounting, the treatment of license fees, and the treatment of transfer/disposal of the beneficial interest in trust. In the case of centralized management by a TLO, consideration should be given separately to the case where the inventor establishes a trust and the case where a university or other corporation establishes a trust. In the former case, the accounting should be processed under the Income Law while in the latter case and the case where the inventor is required to report to the corporation where he belongs, the accounting should be processed according to the rule that the trustee should report to the corporation.

Ⅳ Significance of the Centralized Management of IPRs by Trust

This chapter explains how successfully the trust method will solve problems that are evident in the current centralized management according to the transfer method and the commission method, which are addressed in Chapter I.

1 Possibility of Realizing a Proper Centralized Management

A trustee shall be responsible for various duties under the Trust Law. Among them, ① the duty of care (Section 20), ② the duty of loyalty (Section 22), ③ the duty not to delegate (Section 26), ④ the duty of segregation (Section 28), and ⑤ the duty to provide documents (information) are related to the centralized management of "rights to obtain patents" and "patent rights."

These duties are expected to bring about proper centralized management for business groups or universities. Strictness is needed for the management of "rights to obtain patents" or "patent rights" in particular because the management of these rights requires a steady buildup of efforts.

2 Possibility of Returning Benefits and Providing Incentives to Inventors

A beneficial interest in trust that is attributed to the inventor according to a trust for a third party seems to be excluded from the employee's right to "a reasonable remuneration" under Section 35(3) of the Patent Law. A beneficial interest in trust is a right that is specifically created under the Trust Law, and when IPRs are transferred from a subsidiary to the IP management company or department for centralized management by trust, the beneficial interest in trust is to be automatically attributed to the beneficiary, e.g. an employee or researcher who is employed by the subsidiary. Therefore, the beneficial interest in trust shall not constitute "a reasonable remuneration" under the Patent Law (Section 35(2)) or "wage" under the Labor Standards Law (Section 11) but be provided to the employee or researcher as a kind of incentive payment.

3 Possibility of Solving Problems Arising from the Transfer of Rights

The principle of taxation on the actual beneficiary applies to taxation for trust. Accordingly, even when a "right to obtain a patent" or a "patent right" is transferred or the title to such right is changed to the trustee, it is not necessary to evaluate the right. Compared with the transfer method, the trust method is expected to enable business groups and universities, which are likely to create an enormous number of inventions, to significantly reduce the burden and costs for centralized management. The trust method also makes it possible for them to avoid tax risks due to provisional evaluation of rights, which may occur under the transfer method.

Furthermore, where there is no chance for the trustee to sufficiently utilize a patent right that is entrusted by a university, the trust contract may be terminated and the patent right shall be immediately returned to the university (or researcher), which will enable the university to search for another way of utilizing the patent right. In this case, also unlike the transfer method, it is not necessary to evaluate a patent right for the transfer, and a patent right that is not utilized effectively by the trustee can easily be returned to the university.

Ⅴ Survey on the Actual Situation of the Use of Trusts for IPRs in Foreign Countries

This chapter addresses the results of the survey on the actual situation of the use of trusts for IPRs and the centralized management of such rights in foreign countries.

As examples of the use of "trusts" for IP in the United States and European countries, this survey revealed that trusts were used for the management of copyrights by a copyright management association (Germany), the management of royalties (offshore regions) and securitization (the U.S. and the U.K.)

On the other hand, TLOs in the United Kingdom and the United States operated as fiduciaries, though there was no particular management scheme for patent rights and other IPRs that directly used trusts. TLOs in the targeted countries showed interest in a management scheme that used a trust and emphasized "interaction and joint research between IP experts and trust experts" as one of the future tasks. It was highly surprising that there was almost no interaction between these experts even in the United Kingdom where the trust system was born and the United States, which had the most advanced trust system in the world. This fact underlined that the discussion at this Committee in Japan was ahead of the discussion in the United States and European countries in this field.

Another suggestion obtained from this survey was that there was a substantial need for considering tax benefits in order to operate a trust scheme for the management of rights to obtain patents and patent rights. Management of rights to obtain patents and patent rights centrally rather than individually will be deemed as a kind of business that uses a trust, whether it is profit-oriented or not. In order to provide incentives to use the trust method as a management scheme, it is desirable that tax benefits are granted for revenues from such business. In this respect, one future task is to consider what tax benefits may be granted from the policy perspective.

Ⅵ Toward the Realization of the Centralized Management of Patent Rights by Trust

1 Current Centralized Management of IPRs

① The transfer method, which is one of TLO's methods for managing inventions made by universities, has major operational problems such as the necessity for the evaluation of inventions to be transferred and the tax treatment. On the other hand, under the commission method, the intentions of university researchers will easily be reflected in technology transfer but the researchers are required to manage their own rights, which will increase their burden in research activities.

② The transfer method and the commission method are also adopted for centralized management in business groups. The transfer method raises the same problems as in the case of centralized management in TLOs, the necessity for the evaluation of inventions to be transferred and the tax treatment. There are additional concerns about this method such as the possibility that the interests of the IP management company or department would come first and the issue of compensation for employees' inventions made in subsidiaries. On the other hand, in the case of the commission method, there is concern that the IP management company or department would be constrained by the intentions of subsidiaries, which are the owners of IPRs, and would have difficulty in carrying out the strategic management for the business group as a whole.

③ The use of trust for the centralized management of IPRs will realize an intermediate management method between the transfer and the commission methods, which will be able to solve various problems.

④ Copyrights are successfully handled in

centralized management through trust-based transfer under the Law on Management Business of Copyrights and Neighboring Rights. However, the subjects managed under the Law are limited to copyrights (and neighboring rights), and in light of the difference between copyrights and patent rights, it is impossible to apply this system to the management of patent rights without any modification and therefore further consideration is required.

2 Problems Arising from the Centralized Management of IPRs by Trust

(1) Institutional limit of the use of trust scheme

As IPRs are not included in the types of property in trust listed in Section 4 of the Trust Business Law, it is currently impossible to carry out the centralized management of IPRs by trust as a business. However, in light of the recent social and economic situations, IPRs should be included in the types of property in trust under the Trust Business Law or such limitation of property in trust should be abolished.

(2) Eligibility as Trust Property

Rights to obtain patents and patent rights seem to generally satisfy the requirements for trust property (convertibility into money, existence/specificity, transferability and being as positive property). However, since there is no way to make public "rights to obtain patents," which raises an issue of "specificity," it will be necessary to discuss means of public notice. Due consideration should also be given to the dual structure of a right to obtain a patent that contains the transferable portion (title to the right) and the nontransferable portion (right to be mentioned as inventor) as well as its nature of being contents that are liable to change.

There is also no means to make public technical know-how (trade secrets). However, in light of the current activities involving technology transfer and licensing, the use of the trust system would be less effective if a trust may not be established for technical know-how together with the patent right. In this regard, it is necessary to sufficiently consider how to specify technical know-how as the contents of know-how would change significantly depending on the circumstances.

(3) Relationship between the trustor and the trustee

The types of duties to be born by the trustee are the same irrespective of the relationship between the trustor and the trustee, but the scope of such duties may be expanded or reduced according to special contracts. In the case where the trustee has gone bankrupt, trust property must be secluded from the trustee's property in the separate management and therefore rights to obtain patents or patent rights, which are trust property, will be legally protected (bankruptcy isolation).

3 Accounting and Taxation Treatment

(1) Accounting treatment

Since the trustee's accounting is for the sake of the beneficiary, the trustee should prepare financial reports and basic materials as required by the beneficiary. In the case where the beneficiary is a corporation, the beneficiary's accounting is for the sake of the parties concerned, and therefore it should be processed under accounting standards that are generally considered fair and appropriate. In the case where the beneficiary is an individual such as a university teacher, the accounting is basically needed for his income tax accounting.

(2) Taxation treatment

As revenues from trust property shall not be attributed to the trustee or included in trust property under the tax laws, the tax for the trust is imposed on the beneficiary or the trustor. Where beneficial interest in trust is transferred, it is deemed as transfer of ownership and subject to taxation.

4 Significance of the Centralized Management of IPR by Trust

① Where a trust is used for the management in a business group, it will bring about advantages of both transfer and commission methods.
② As the trustor retains the beneficial interest in trust, revenues such as royalties may be returned to the trustor.
③ The trustee shall bear various duties including the duty of care and the duty of loyalty, which will realize proper management of IPRs.
④ Due to pass-through taxation for trusts, more economic benefits are expected than in the case of the transfer method or the management method where an exclusive license is granted to the manager.

5 Institutional Designing for the Centralized Management of IPRs by Trust

① Management of rights to obtain patents or patent rights requires technical knowledge on the management and utilization of such rights. For this reason, where the trustee builds up another scheme and uses an expert as an attorney, it is necessary to clarify the burden sharing between the trustee and the attorney in advance.
② The major opinion was that, considering the characteristics of the centralized management of rights to obtain patents or patent rights by trust, the current requirements for the entry into trust business should be relaxed so as to only require the

registration to the competent minister as applied under the Law on Management Business of Copyrights and Neighboring Rights. On the other hand, some suggested that consideration should be given to consistency with statutory regulations (approval and license) that are imposed on general trustees of commercial trusts.

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