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Japan's Trade Secret Law Reform Should Focus On Discovery

Law360, New York (October 22, 2014, 3:51 PM ET) ----

Japan is a well-known enclave of advanced technologies developed through the innovation and persistent quality improvement efforts of its domestic industries. Among industrialized countries, Japan enjoys a comparative advantage in the production of high-quality goods utilizing advanced, automated manufacturing processes.

Although Japan's novel product offerings are protected by a stable and well-developed domestic patent system, recent instances of trade secret theft lay bare the weaknesses inherent in Japanese trade secret law and its inability to protect the heavy investment of Japanese companies in technologies they depend upon for their competitive edge. In very recent history, newspaper headlines in Japan have been dominated by stories of Japan's largest corporations losing trade secrets to foreign competitors through the exploits of former employees.

For example, in March 2014, reports swirled in the press that Toshiba Corp. was cooperating with authorities in a case involving a former employee of joint venture partner, SanDisk Corp., who is accused of disclosing Toshiba's latest NAND flash memory trade secrets to Korean based SK Hynix. The former employee is accused of downloading Toshiba's flash memory research data on to a portable storage device before resigning from his position in 2008 and then disclosing the copied data to his new employer, SK Hynix in Korea.[1]

Also, as recently as May 13, 2014, a former Nissan Japan employee was arrested in Kanagawa Prefecture on charges of trade secret theft.[2] Before his July 2013 resignation from Nissan's Technical Center in Atsugi, Japan, the former employee allegedly copied more than 5,000 electronic files related to Nissan marketing plans on to a portable storage device. It is alleged that the former employee intended to sell the information to Nissan's competitors.

Impetus for Reforming Japanese Trade Secret Law and Procedure

Faced with this growing trend of trade secret theft, Japanese lawmakers are actively debating reforms to strengthen both civil and criminal enforcement of trade secrets.[3] For example, as recently as Sept. 30, 2014, Japan's Ministry of Economy, Trade and Industry commenced a formal initiative to improve trade secret enforcement in Japan.[4] The objective of that effort is the proposal of new legislation sometime next year to revise Japan's trade secret laws.[5]

Most of the reform proposals currently under consideration focus on enhancing both civil

remedies and criminal penalties as means to deterring future trade secret theft.[6] Those reform proposals, however, are short-sighted and fail to address the fundamental weakness of trade secret enforcement under current Japanese law. Deterrence of illegitimate conduct depends upon not only the severity of penalties, but also, and perhaps more importantly so, the probability of getting caught and held accountable.[7] It is this latter point on which Japanese law is woefully lacking.

Despite prior reforms aimed at strengthening trade secret enforcement, many aggrieved Japanese companies still do not pursue relief in the Japanese courts. Their reluctance may be due, in part, to a desire to avoid unfavorable publicity, but it is more likely driven by the too frequent futility of proving misappropriation and damages. Discovery is still severely constrained in Japanese courts, materially impairing an aggrieved party's ability to marshal the evidence needed to prove trade secret theft and to establish damages. It is as if current law provides the weaponry for trade secret enforcement while denying the necessary evidentiary ammunition needed to make effective use of the armaments.

For example, under Japanese law, an aggrieved trade secret owner may enjoin the accused's wrongful conduct, seek destruction of goods made with stolen trade secrets, and request removal of facilities utilizing the trade secrets.[8] In addition, the trade secret owner may seek lost profits, disgorgement of the accused's profits, or reasonable license fees for the use of the stolen trade secrets.[9] However, proving misappropriation under Japanese law is not straightforward, requiring, for example, evidence that trade secret was acquired by "theft, fraud, duress, or other wrongful means" or that the trade secret "was used or disclosed as a result of wrongful acquisition." [10] Compounding this complexity is the lack of judicial assistance given to plaintiffs in obtaining evidence from accused parties.

Prior legislative reforms attempted to implement document discovery in Japanese litigation to address these concerns, but those efforts resulted in statutes with rule-swallowing exceptions that have tended to frustrate the exchange of evidence. For example, although Japanese law authorizes courts to order production of "any documents necessary for proving the act of infringement or assessing the amount of damages," that same provision instructs, "this does not apply when the holder of the documents has justifiable grounds for refusing to submit them." [11] The grounds for denying a request for document production can be the accused party's asserted need to protect its own confidential business information when such necessity substantially overcomes the necessity of document production.

As a result of this proviso in the statute, Japanese courts frequently either reject the plaintiff's evidence request outright or engage the parties in such protracted briefing over the grounds for refusing production that the case ends in dismissal for failure of proof or otherwise concludes without a ruling from the court on the discovery motion.[12]

This judicial reticence in ordering production of evidence is not new in Japan. Japanese courts and Japanese lawmakers alike have long been wary of broad, American-style discovery, fearing that the discovery rules themselves could be abused and thereby diminish the intellectual property value of parties ensnared in litigation. Paradoxically, the inability to effectively enforce trade secret rights in Japanese litigation likewise reduces the value of IP rights. From an historical perspective, the fears concerning discovery risk and abuse have proven to be unfounded.

That history includes the half-century of Japanese corporate experience litigating in the U.S. where Japanese technology has been the subject of extensive discovery under federal and state procedural rules. For example, our survey of the CourtLink database found that Toyota Motor Co. has been involved in more than 1,000 civil actions in the United States since January 1980. Despite a multitude of such Japanese-related cases ensuing throughout the United States, instances of discovery violations are virtually nonexistent. In this context, liberalization of discovery in Japanese courts does not require radical experimentation, but instead implementation of a few time-tested procedural tools and safeguards familiar to U.S.

litigants, including Japanese companies who litigate in U.S. courts.

Flexible Protective Orders

Japanese courts may be more inclined to order document discovery under existing law if the producing party's secrecy concerns can be addressed by an appropriate protective order. Ironically, current Japanese law permits the courts, upon motion of a party, to enter protective orders that forbid the parties and their counsel from disclosing or using an opponent's information for purposes other than the litigation.[13] In practice, however, litigants seldom seek such an order because of the harsh criminal penalties imposed for violating a court order — up to five years of imprisonment and a 5 million yen fine.[14]

In contrast, the practice that has evolved in U.S. litigation under Fed. R. Civ. P. 26(c) and 37 provides a more flexible approach to both the scope of protective orders and severity of sanctions. For example, most protective orders in U.S. litigation are stipulated, meaning that the parties negotiate and reach agreement on the rules governing the exchange of discovery, including the designation of “attorneys--eyes--only” and “confidential” information as well as the designation of company personnel who may review an opponent's confidential information. That flexibility of practice is currently lacking in Japan.

Moreover, unlike their Japanese counterparts, U.S. courts are not confined to a narrow menu of penalties for sanctioning protective order violations. Instead, U.S. courts exercise broad, flexible powers in fashioning sanctions to address a protective order violation. In practice, the authority granted by Rule 37 and the courts' historic use of that authority have not deterred parties and their counsel from requesting protective orders. Over the years, that practice has effectively facilitated the exchange of sensitive evidence while working to deter discovery abuse.

Duty to Preserve Evidence

An invigorated discovery practice in Japanese courts requires revisiting Japanese law on the preservation of evidence. In U.S. practice, the body of case law that has developed regarding evidence preservation and spoliation is a significant feature of U.S. litigation that works to ensure the integrity of the judicial process.

In short, potential litigants have an affirmative duty to preserve evidence under U.S. law concerning a potential cause of action or defense that begins as soon as litigation can be reasonably anticipated.[15] That affirmative duty requires potential litigants to stop automated data deletion and document destruction programs that are in effect under their information management systems and to preserve the evidence throughout the anticipated litigation.[16] Despite the difficulty in ascertaining the timing and boundaries of the duty, parties guided by counsel in U.S. litigation, for the most part, have successfully navigated these requirements.

Japanese law also has provisions directed to evidence preservation, but unlike U.S. law, the duty does not arise automatically. Instead, Japanese law permits a court to enter a preservation order when it perceives a need to do so or when a party has formally petitioned the court for a preservation order.[17] As a practical matter, without discovery, a party typically cannot specify the evidence that should be preserved at the outset of a case, and there is no independent duty to preserve evidence in the absence of an order. Implementing an expanded, self--executing duty that arises when litigation is anticipated would further enhance the integrity of the Japanese courts and ensure that decisions are based more fully on the facts and circumstances of each case.

Amendment to Statutory Trade Secret Definition

Another aspect of Japanese trade secret law crying out for greater flexibility is found in the

statutory definition of a "trade secret." Japanese law defines a "trade secret" as (1) technical or business information useful for business activities, such as manufacturing or marketing methods, (2) that is kept secret, and (3) that is not publicly known.[18]

The second element of this definition has proven the most challenging for trade secret owners in litigation. Although Japanese courts have been making efforts to consider company size and typical business practices when applying this element of the statutory definition, trade secret owners are often faulted for implementing less than optimal security procedures, and lose their case on those grounds alone. Even companies who have invested heavily in security stumble in court where they fail to prove which of their specific security measures were applicable to the conduct resulting in misappropriation.[19]

By comparison, the competing ends between good business practice and the legal prerequisites to trade secret enforcement are more delicately balanced in U.S. litigation, especially in those states that follow the trade secret definition provided in the Uniform Trade Secrets Act. The UTSA permits enforcement where the trade secret owner demonstrates that its internal security measures were "reasonable under the circumstances to maintain secrecy." [20] Introducing similar language into the due care aspect of Japan's statutory trade secret definition would give Japanese courts greater latitude in evaluating the caution exercised by trade secret owners in protecting their valuable information.

Confidentiality and Noncompetition Agreements

The recent headline--grabbing news stories about disloyal former employees have focused the reform debate in Japan on what can be done to protect employers from their employees. There have been renewed calls for strengthening noncompetition agreements as an additional barrier to trade secret theft. However, the potential scope of legal reforms aimed at enhancing post--employment restrictions is limited.

Japan's Constitution forbids laws that infringe an individual's freedom to choose employment. [21] Similarly, Japan's Civil Code permits courts to void contracts that offend public policy. [22] Therefore, Japanese courts only enforce noncompetition agreements that are reasonable with regard to, among other things, the duration, geographic boundaries and substantive scope of the post--employment restrictions.[23] Each case is fact specific, and it is difficult to predict how a court will rule when evaluating those factors in any particular case.[24]

Consequently, greater demands will be placed on nondisclosure provisions in employment contracts in addressing Japan's increasingly mobile workforce. Nondisclosure agreements have generally worked well in the United States, even in highly mobile labor markets such as Silicon Valley that is located in a state that does not enforce post--employment, noncompetition agreements.[25] The effectiveness of nondisclosure agreements in the U.S. undoubtedly is owed, at least in part, to the liberal discovery available in U.S. litigation. In the absence of more robust discovery under Japanese law, it remains uncertain whether Japanese employers can effectively utilize non--disclosure agreements in the same way to enforce trade secret rights against their former employees.

Concluding Remarks

The influences of globalization, consequences of corporate downsizing, and generational shifts away from the tradition of lifetime employment are all conspiring to increase the frequency and severity of trade secret theft in Japan. Japanese companies present lucrative targets for those dealing in stolen technology. The goal of Japan's policymakers and its courts should be to protect those companies from becoming easy targets of trade secret theft. The enforcement of trade secret rights in court is an important aspect of that objective.

As discussed, Japan's trade secret law has many beneficial features but places trade secret owners at a disadvantage by keeping needed evidence beyond their reach. The few, practical

proposals made in this article would significantly aid the parties in marshaling evidence to prove their claims and defenses, and, importantly, enhance the ability of Japan's courts to adjudicate cases on their merits.

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[1] See <http://ajw.asahi.com/article/business/AJ201403140042>.

[2] See <http://www.japantimes.co.jp/news/2014/05/13/business/ex--nissan--worker--stole--trade--secrets/#.VDvVslYrzwI>.

[3] See, e.g., http://ajw.asahi.com/article/behind_news/social_affairs/AJ201406160043.

[4] http://www.meti.go.jp/committee/sankoushin/chitekizaisan/eigyohimitsu/001_giji.html

[5] <http://www.kantei.go.jp/jp/singi/titeki2/kettei/chizaikeikaku2014.pdf>

[6] Id.

[7] See Gary S. Becker & William M. Landes, *Essays in the Economics of Crime and Punishment*, 9--14 (1974).

[8] See Article 3(1) & (2) of Japan's Unfair Competition Prevention Act.

[9] See Article 4, 5(1), (2) & (3) of Japan's Unfair Competition Prevention Act.

[10] See Article 2(1)(iv) of Japan's Unfair Competition Prevention Act.

[11] Article 7(1) of Japan's Unfair Competition Prevention Act.

[12] See, e.g., July 16, 2013 judgment of the Osaka District Court (motion for production of evidence denied;; case dismissed for failure to prove that accused source code utilized alleged trade secrets).

[13] See Article 10(1) of the Unfair Competition Prevention Act.

[14] See id. at Article 21(2)(vi).

[15] See, e.g., *Fujitsu Ltd. v. Fed. Express Corp.*, 247 F.3d 423, 436 (2d Cir. 2001) (duty arises when litigation may be reasonably anticipated).

[16] See, e.g., *915 Broadway Assocs. LLC v. Paul, Hastings Janofsky & Walker, LLP*, No. 403124/08, 2012 WL 593075 (N.Y. Sup. Ct. Feb. 16, 2012) (failure to suspend destruction of backup tapes and email deletion).

[17] See, e.g., Articles 234 & 237 of Japan's Code of Civil Procedure.

[18] Article 2(6) of the Unfair Competition Protection Act.

[19] See June 1, 2012 decision of the Tokyo District Court (Even though plaintiff showed that access to the information was controlled by several means, including unique identification numbers and passwords, plaintiff failed to prove which specific restrictions were in place at the time of the misappropriation).

[20] See, e.g., California Civil Code § 3426.1(d)(2).

[21] Article 22(1) of Japan's Constitution.

[22] Article 90 of Japan's Civil Code.

[23] See, e.g., October 23, 1970 decision of the Nara District Court, civil collection 21, scroll 9 at 10(1369).

[24] See, e.g., September 27, 2013 decision of the Tokyo District Court, labor law journal 21(10) (employment restriction of less than six months invalidated as unreasonable).

[25] See, e.g., Section 16600 of California Business and Professional Code, et. seq.

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