



## **Additional Employee Inventor Compensation – A right too far?**

### ***Introduction***

The issue of employee inventions and the extent to which employee inventors should be compensated has in recent times become a hot topic in the UK. Since the Patents Act 1977 there has been a statutory right for employees to be awarded additional compensation over and above their salary for patented inventions made by them during the course of their employment where *“having regard among other things to the size and nature of the employers undertaking, the invention or the patent for it (or the combination of both) is of outstanding benefit to the employer; and, by reason of those facts it is just ...”*<sup>1</sup> for an award to be made.

The thinking behind an employee being entitled to further compensation for outstanding inventions was considered by the Banks Committee in its 1970 report into the Patent System and Patent Law - the “Banks Report”. The Banks Report noted that there was a view that the concept of “master and servant” did not fit with modern views and that there was a concern that it was unfair that an employer was automatically entitled to an employee’s invention without further payment even if the invention was so outstanding that it resulted in substantial profits to the employer. It was suggested that this position would provide no encouragement to inventive employees. Not surprisingly, industry held a different view, that *“... the system of rewarding work by salary increases, promotion and special bonuses is capable of catering satisfactorily for all forms of meritorious work carried out by employee whether the work is patentable or not”*.

Indeed, there seems to be a lot of sense in the view given at that time from industry. Why should those employees in research and development be any different from, for example, those in marketing or sales? One would never dream of there being legislation in place to give an employee in marketing a statutory right to extra pay for coming up with a new slogan or advertisement, no matter how novel, even if it did lead to massive sales. Similarly, neither would one expect legislation to provide for extra compensation to an employee who creates a particularly clever website design or way of doing business, or, even going back to patents, the inventive patent attorney who manages to properly identify the invention and claim it! The view reported on in the Banks Report was right that in a modern world new considerations should apply but the reality is that presently employees are more mobile than ever and in many cases will and can change employers if they do not feel properly recognised and incentivised. Therefore, it could be said that 40 years on from the Banks Report the modern world dictates that instead of leaving it to statute one should leave it to the free market to arrive at fair terms.

It is worth noting that in the US there are no similar employee compensation laws and no one can say this held back their great industrial achievements!

However, the UK is not alone in having given employees further compensation in respect of their inventions. Below we will further consider the position in the UK, together with a look at the different employee inventor compensation regimes in Germany and France.

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<sup>1</sup> Section 39 Patents Act 1977, discussed further below

## **UK**

Section 39 of Patents Act 1977 provides that inventions made by employees in the course of their normal duties or duties specifically assigned to them will belong to their employer. This can be contracted out - although this would be unusual.

Section 40 provides that in respect of an invention belonging to the employer, for which a patent has been granted, if that patent (or invention and/or patents where the relevant patent has been filed after 1 January 2005) is of outstanding benefit to the employer, having regard among other things to the size and nature of the employer's undertaking, it is just that the employee should be awarded compensation. The Courts have been reluctant to redefine "outstanding" in this regard, but have said it denotes something special<sup>2</sup>, something more than significant or substantial<sup>3</sup>. The benefit "*... must be looked at in the total context of the activities of the employer concerned to see whether it is outstanding*"<sup>4</sup>.

The first contested case to result in an award for employee compensation was that of *Kelly v GE Healthcare*<sup>5</sup>. In the Kelly case the inventors were involved in the first synthesis of compound "PS3" which formed the basis of Myoview, which is a heart imaging agent. On the evidence, Myoview had been critical to the success of Amersham (which subsequently became part of GE Healthcare). However, what was important to the case was whether the patent itself was of outstanding benefit. On that matter, Mr Justice Floyd said yes because without the patent the generic competition "*... would not simply have been a major issue, it would have been a crisis for Amersham*" plus the patents had "*been a major factor in achieving the corporate deals*". Mr Justice Floyd said he had no difficulty in recognising that the patents were of outstanding benefit.

But was it just to make an award? Here Mr Justice Floyd did not give too much by way of guidance in his judgment. He noted that other employees (not inventors) would have contributed to the invention but said that did not make it unjust to make an award. He was also unimpressed by the fact that the inventors had carried no risk - the risks were all Amersham's. He said it was just to make an award.

On how to value the benefit Mr Justice Floyd was presented with two alternatives. GE Healthcare argued that the Court should look at what royalty Amersham would have otherwise had to pay. The employees argued that the Court should look at the chance of reduced profits had there been no patents and presented some possible percentages. Ultimately, Mr Justice Floyd said one needed to look at actual benefit and sided more with the employees' approach. He looked at the period of time for which the patents gave exclusivity and, without any detailed reasoning, took a price cut of 10% without the patents and arrived at a figure of £50m, which in his own words was very conservative. On determining fair share Mr Justice Floyd stuck to the letter of the relevant statutory provision<sup>6</sup> and took into account the inventors' positions, remuneration, efforts and the skills of the inventors and other persons involved in the invention and the contribution made by the employer in creating the opportunity. In the end, Mr Justice Floyd gave one inventor 2% and the other 1% which resulted in payments of £1m and £500k respectively. In reaching what was in his view to be a fair share one might be excused from thinking Mr Justice Floyd had actually always had a final number in mind that he was going to award, and went back from there to calculate. In truth, the Kelly case gives no real guidance as to how to approach calculating the amount to be awarded, and the case very much turns on its facts. It does,

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<sup>2</sup> *Memco-Med Ltds Patent* [1992] RPC 403 - Mr Justice Aldous (as he then was) at page 414

<sup>3</sup> *GEC Avionics Ltd's Patent* [1992] RPC 107

<sup>4</sup> *GEC Avionics Ltd's Patent* [1992] RPC 107

<sup>5</sup> *Kelly & Chiu v GE Healthcare Ltd* [2009] RPC 363

<sup>6</sup> Section 41(4) Patents Act 1977

however, present what may be considered to be a high water mark in that the invention concerned was pretty much the product and it was the product that made the company.

For the vast majority of cases the invention will not be the product itself but rather just a part or component thereof, and so it may be very hard to ascribe a value to the benefit that a particular invention/patent gives. Or will it? The introduction of the UK Patent Box, whereby a company's profits from the sales of products can be subject to a favourable corporation tax rate of 10% if they are covered by a qualified patent, may help value the benefit derived from that patent/invention. The benefit the company reaps will extend beyond the technical contribution of the parties since the patent needs only to cover one element of the product concerned to qualify for the Patent Box.

Since the Kelly case there is one further case that has reached trial. This was the case brought by Professor Shanks against Unilever. The facts of that case are that Professor Shanks (the employee) had created an invention that, although it had not been directly exploited by the employer (Unilever), had been extensively licensed by Unilever for revenues in excess of £23m. The trial of this case took place in April 2012 in the UK IPO and at the time of writing some eight months later the parties are still waiting a decision. It seems likely that the hearing officer, Dr Elbro, will give some guidance as to how to determine whether an invention is of outstanding benefit and the relevance of the size of the employer's undertaking to that. In an earlier Court of Appeal decision<sup>7</sup> in the Shanks case, relating to a preliminary issue on a construction point on the legislation, Lord Justice Jacob had said *"I am far from convinced that Parliament meant that inventors/employees of large companies should get less or no compensation for a particular invention compared with what they would get if they had been employed by a small company."* This comment would seem to ignore the fact that the legislation requires the *"size and nature of the employer's undertaking"* to be taken into account. Perhaps though, the greater concern to all innovative companies with research and development in the UK is that part of the Professor Shanks case is that when determining the fair share the court should have regard to whether a different level of exploitation may have resulted in greater or lesser benefits for the employer. The consequences on the UK could indeed become extremely harmful if it were correct that there is somehow an obligation placed upon the employer to ensure that it has explored all possible routes when exploiting patents - particularly if the invention is not core to the employer's activities.

Given that there have been so few employee compensation cases to reach the courts, one could assume that that in the UK relatively few claims are ever made. However, this is not what we hear from industry. Indeed, it seems that such claims are on the increase, perhaps encouraged by the awareness created by the Kelly case and by the shift from solely the patent being required to be of outstanding benefit to the invention itself being considered as well. It may be that such claims will in time increase, with lawyers being able to act on a contingency basis from next year.

As mentioned previously the logic behind the employee inventor being entitled to bring an additional claim for compensation over and above his/her contractual remuneration is questionable - particularly in the modern world. The position is also unclear for multi-national corporations with employees in different jurisdictions since there is little, if any, harmonisation across jurisdictions.

Given the shortcomings and confusion of the UK system, it is worth considering whether things are any better elsewhere. The employee compensation system most widely referred to is the German system. This is quite different to the UK and elsewhere.

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<sup>7</sup> *Shanks v Unilever PLC* [2011] RPC 12

## **Germany**

The position of employee inventions in Germany is governed by the German Employee Inventions Act 1957 ("ArbnErfG") and subsequent ministerial guidelines. The law was amended in October 2009. It has its history from the days of the Third Reich when politically the government wanted to show it was pro worker.

The position on ownership of and rights to inventions is somewhat different to the UK. In Germany, inventions are divided into two categories, Service Inventions and Free Inventions. Service Inventions are those which are made in connection with the inventor's employment. Free Inventions are those which are not connected with the inventor's employment.

The basic premise is that patent rights connected with an invention rest with the employee inventor. The employer, however, has certain rights. For a Service Invention the employer is entitled to acquire the exclusive rights to the invention. Prior to 2009 this would involve the employee filing a report upon making the invention and then the employer, within four months of such filing, making a written claim to the invention. On proper receipt of a written claim, all rights connected with the invention would pass to the employer. If the employer does not make such a written claim then the invention would become a Free Invention and would belong to the employee. Post 2009 the regime is less strict for the employer, in that the default position is that the employer has claimed the invention unless the employer has formally released it within four months of the employee's invention report.<sup>8</sup>

In respect of Free Inventions made by the employee outside of his/her employment, the employee is still required to notify the employer unless it is obviously unconnected with the employer's business. If the invention does relate to the employer's business, then the employer is entitled to a non-exclusive licence at a reasonable royalty.

In respect of Service Inventions the German law also places burdens on the employer to file for patents<sup>9</sup>. If the employer does not act expeditiously in filing the necessary patent applications the employee can require the employer to do so within a set time. If the employer does not comply then the employee can have a patent application prepared and filed in the employer's name and then seek payment of the bill for this from the employer. Furthermore, even if the employer does expediently apply to obtain patent rights, if the employer subsequently decides to discontinue such an application or subsequently not to maintain the rights, then the employer must notify the employee, and if requested, transfer the rights to the employee; although the employer would be entitled to a non-exclusive licence at a reasonable royalty. The legislation relating to rights in inventions is aimed at protecting the employee but it does to an extent protect the employer as well.

In addition to the rights above, the employee is entitled to claim "reasonable compensation" from the employer once the employer has claimed the Service Invention<sup>10</sup>. As to how this is assessed, Section 9(ii) of the ArbnErfG states that due consideration should be given "to the commercial applicability of the Service Invention, the duties and position of the employee in the enterprise and the enterprise's contribution to the invention".

The statutory guidelines give a standard formula as to how compensation is calculated. This is  $V = E \times A$  where  $V$  is the annual compensation,  $E$  is the invention value and  $A$  is the contribution made by the employee.

So far so good, and one would think with a standard formula there would be certainty as to how any compensation is calculated. Not surprisingly, it does not work like this. Calculating

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<sup>8</sup> Section 6 ArbnErfG

<sup>9</sup> Section 13 ArbnErfG

<sup>10</sup> Section 9 ArbnErfG

value is not so straightforward, with numerous approaches being taken, such as what royalties would be paid for the invention, how much the employer gains or saves by using the invention, what the employer would pay to acquire the invention if it had been a Free Invention etc. Calculating the employee share is not easy either. A points system is used to calculate this. Points are awarded on three criteria relating to: (i) task (up to six points, the greater the initiative the greater the points); (ii) solution (up to six points - the more unusual or unexpected the greater the points); and, (iii) the employee's position in the company (up to eight points - the more junior or unskilled the greater the points). Thus, the number of points can range from three to a possible twenty with this equating to a share ranging from 2% to 100%.

In Germany, unlike the UK, there is an automatic right to compensation but in reality the amount is no easier to calculate. Disputes can be dealt with by a non-binding arbitration board in the German Patent Office or, failing that, by the Courts - although this is rare. In view of the inefficiencies and uncertainty of the system, employers tend to routinely automatically pay employees a lump sum soon after the employer has filed an invention statement. This lump sum will also cover the employer's obligations to seek and maintain patent rights etc. The amounts paid generally tend to be relatively low but they can be significant depending upon the product. In some cases the employee may claim for compensation adjustments.

### **France**

As in Germany, the starting point is that any inventions belong to the employee. However, the Intellectual Property Code 1992 ("IPC") sets out three different categories for inventions - Mission Inventions, Non-Mission Inventions and Free Inventions.

Mission Inventions are those which have been made in the course of employment as a result of the employee's duties. The employer is automatically entitled to such inventions.

Non-Mission Inventions are those inventions made during the course of the employee's job using the employer's technology / know how but not as the result of the employee's duties or research assigned to him/her. If the invention relates to the business activities of the employer then the employer will have a right to request the assignment of the invention to it in return for a fair price paid to the employee.

Free Inventions are those which are not connected to the inventor's employment. These will belong to the employee without any obligation to the employer.

The history of the provisions relating to employee inventions in the IPC lie with the Patent Act 1978, which also introduced a statutory right for additional compensation to employee inventors. Up until then, French law did not provide for additional compensation for Mission or Non-Mission Inventions. In respect of Non-Mission Inventions, French law stated that these were co-owned. The 1978 Act simplified that by instead making the employee the owner, with the employer having the right to claim an assignment in return for a fair price which in practice is linked to the value of the invention.

Article L.611-7 of the IPC provides that the conditions under which an employee inventor of Mission Inventions "... **shall** enjoy additional remuneration shall be determined by the collective agreements, company agreements and individual employment contracts". Prior to an amendment in 1990 the **shall** was a **may**, and this small change from the word **may** to **shall** has been interpreted broadly by the French Courts to mean that the employee inventor must be awarded additional remuneration in all circumstances.

The legislation does not give any guidance as to how this additional remuneration should be calculated. For a while it was thought that the additional remuneration could be arrived at by reference to the salary of the employee with awards amounting to between two and twelve months' salary. However, in more recent times the French Courts have rejected this approach and have not linked awards to the employee's salary, but rather to the profits or savings made by the employer using the invention. This trend started with the Supreme Court case in 2000 of *Raynaud & Labrie v Roussel & Hoechst*. On the facts of the case the

employer had made over €100m in France through licensing of an invention relating to a pharmaceutical product for the treatment of prostate cancer. In that case there was a collective agreement for the chemical industry. However, while there was provision for additional remuneration under that agreement there were no contractual provisions describing exactly how the remuneration should be determined. The Court ignored the inventors' salary and instead looked at the facts and matters surrounding the research and how the invention was made, and the contribution made by the inventors. In doing this it arrived at a sum of €600k to be paid as additional remuneration. Arguably, this case can be seen as an exception, and awards made by the French Courts since then have been more modest but can still be very high. With the award in respect of Mission Inventions being linked to the value of the invention it has meant that practically speaking there is less difference between the awards made for Mission and Non-Mission Inventions.

The position for public sector employees is very generous. The IPC provides that *"... the additional remuneration referred to in Article L.611-7 shall be constituted by a bonus share in the revenues derived from the invention by the public entity that is the beneficiary of the invention"*<sup>11</sup>. There are statutory rules which govern how these bonus payments are calculated, often taking the form of a royalty generally set at around 25% of the net revenue usually received by the employer. In addition, the inventor will always receive a bonus of around €3000. It follows that claims in the public sector can be high.

There are many claims for remuneration brought in the French Courts. One active debate at present in France is the time in which an employee should bring a claim. Employees very often leave it until after they have left the employment or even at the end of any patent life. There is a question as to what laws on limitation period should apply with employees pushing for a period of up to 25 years from the time the claim could have been brought. As in the UK this can provide uncertainty and any payment can be reconsidered. Many employers have schemes in place to provide extra remuneration in respect of inventions which serve to help reduce the likelihood of claims.

### **Final comments**

Most countries in the EU have statutory provisions to provide employee inventors with additional compensation. In countries such as Germany, where the awards are mostly decided in the early days of exploitation, the awards are most often relatively low. In the UK the employee has until one year from the expiry of the last relevant patent (wherever that may be) to make a claim, and the tendency is for employees to make the claims towards the end of that date, often by which time they have left their employment. As things stand in the UK only a very small number of claims have ever reached the Courts and only one case has resulted in an award - *Kelly v GE Healthcare*. That case on its facts was to an extent exceptional and most likely represents the ceiling of what awards a Court may make. Of course, in that case it was the patent itself that needed to be valued. For patents filed since 1 January 2005 it is now the patent and/or invention to be valued and thus in the future the value of the benefit to an employer may be decided more generously. However, while reports from industry are that it is increasingly less unusual for employees to seek further compensation, the cost of litigation and lack of clarity as to how to assess *"outstanding benefit to the employer ..."* and calculate value and fair share do not encourage claims to be made in the Courts.

The thinking behind the legislation was to protect employees and to encourage inventive activity. It was to give fairness to a perceived imbalance that the employer owns the invention which the inventor has by definition arrived at by doing something not obvious, and so "above and beyond". However, the effect of the legislation has been to target one very small category of employees ignoring the many other employees who are involved in the development of new products and whose contributions may have in reality have been just as crucial in, for example, initiating the research and getting the product to market. In the pharmaceutical industry, by way of example, just think of the very many people who

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<sup>11</sup> Article R.611-11, IPC

are involved in bringing a drug to market, all of whom would be crucial to its success, e.g. those in product development, clinical trials, regulatory, sales and so on. Many drugs may not even make it to market for clinical safety reasons but the researchers may not have been any less inventive than those who worked on inventions that do make it through clinical trials etc. To be part of one team as opposed to another may to an extent have been simply an element of luck. Indeed, there is a risk that the existence of rights for employees to seek additional compensation may in effect help achieve the opposite of protecting and encouraging inventive activity. The uncertainty of interpretation of relevant provisions may make certain employers less inclined to make voluntary awards for inventions (although, in the UK such awards would be taken into account when considering whether the employee is entitled to any further payment) and in extreme cases national legislation may even encourage businesses to move research to other jurisdictions. What is clear is that employers should give thought to this topic and look at ways to reward and recognise inventive activity. When putting such schemes in place one should take note of the law in the relevant jurisdictions in which they operate.

Finally, just by touching on the three jurisdictions above one can see that the rules vary significantly, which may give rise to some circles saying this is an area ripe for harmonisation. However, be careful for what you wish for. Remember the Unitary Patent Court!

Of course, one route of harmonisation may be for all rights for additional employee compensation to be abolished. Indeed when one goes back to the origins of the UK law the concern voiced and reported on by the Banks Committee was that the law at that time was not in line with the modern world but that modern world of the 1960s and 1970s has now gone and in today's modern world as noted above employees are more mobile than ever, and in many cases will and can change employers if they do not feel properly recognised and incentivised. If employers want to nurture and keep their best talent they need to reward and value them, otherwise their competitors will. Statutory rights against the employer are unlikely to encourage employee inventiveness.

Huw Evans, 18 December 2012