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RECENT DEVELOPMENT CONCERNING POSSIBLE CLAIM BY AN EMPLOYEE TO ROYALTIES FOR INVENTIONS

Until recently, the prevailing view was that an agreement between an employer and employee that provides that the employee transferred "all their rights" to any inventions created in the scope of their employment was sufficient to preclude the employee from receiving royalties for such inventions. A recent decision by the Israeli Compensation and Royalties Committee (a Committee formed under the Patent Law 5727-1967) (the "Committee") has raised questions as to the fundamental ability of employers to obtain royalty-free assignments of inventions developed by employees during their term of service. Employers are well advised to review their agreements to ensure that their intellectual property assignment provisions are properly drafted. In addition, potential purchasers of companies should take special care to review intellectual property assignments in their due diligence reviews.

Factual Background

Ishai Ilani was employed by Actelis Networks, a provider of Carrier Ethernet over networking equipment. In 1999, he signed a standard Confidentiality and Proprietary Undertaking, the relevant portion of which states:

> *"I hereby undertake as follows: …*
>
> *All Proprietary rights, intellectual property rights, rights of development and commercialization shall be vested solely with the Company, unrestricted and unreserved.*
>
> *I hereby assign and transfer in full all rights I have and will have to any invention and development which the Company will be developing during my employment with the Company, and I undertake to sign and enter any document, authorization and assignment required to affect [sic] the registration of all intellectual property rights on [sic] the name of, or at the order of, the Company."*

During the course of his employment, Ilani developed an invention. As this was created in the scope of his employment, this is referred to as a "service invention" under Section 132 of the Patent Law. Actelis filed two provisional patent applications in the United States, and a Patent Cooperation Treaty application for Ilani's service invention. In 2008, the patent application in Israel entered the national phase. Later that year, Ilani filed a motion to the Compensation and Royalties Committee under the Patent Law for compensation for his service invention.

Section 134 of the Patents Law states:

> *"if there is no agreement determining whether, to what extent, and on what conditions, an employee is entitled to remuneration for a service invention, then the matter shall be decided by the Compensation and Royalties Committee".*

Actelis responded by moving to dismiss Ilani's motion on two grounds.

First, Actelis claimed Section 134 is not relevant because it should only apply in circumstances where there is no agreement regarding the employee's rights in the service invention. Actelis relied upon the Undertaking and argued that it constituted an agreement between the employer and employee whereby Ilani assigned all of his rights in the service invention to his employer.

Second, Actelis argued that Ilani's motion was theoretical and premature

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since Actelis had not yet begun to use or gain profit from the invention.

The Decision

On the first issue, the Committee decided that if Actelis was interested in Ilani waiving his rights to compensation in his service inventions, it should have been explicitly stated this in the Undertaking. The Undertaking did not explicitly refer to a waiver of royalties and also failed to expressly refer to Section 134. Accordingly, the Committee determined that Actelis failed to secure a waiver of Ilani's right to royalty payments because the Undertaking did not constitute an agreement regarding remuneration for a service invention. The absence of an agreement meant that the Committee was free to determine the amount of remuneration that Ilani should receive.

The Committee further raised the possibility that an employee's right to compensation is a personal right and therefore non-assignable. So even if the proprietary rights in the invention have been assigned, the personal right to compensation remains with the employee. The Committee stated that in this case, it did not need to resolve this fundamental question because there was no express waiver of Ilani's right to royalties.

On the second issue, the Committee determined that the motion was not premature even though the invention was not being utilized. The Committee cited Section 135 of the Patent Law, which states that in the absence of an agreement concerning the payment of royalties for a service invention, the Committee may consider not only the actual exploitation of the invention but also the "possibilities of exploiting the invention". Therefore, the fact that the invention was not yet in use did not prevent the Committee from considering the extent of remuneration to which Ilani was entitled.

Analysis

The Committee's decision raises two main issues:

- The position of the Committee is that a mere assignment of invention does not imply that the employee agreed that he or she is not entitled to royalties. The Committee is of the view that an agreement with respect to the terms and conditions of any royalties or waiver thereof, needs to be explicit and that an interpretation of the agreement (including, perhaps use of "magic words", such as a referral to the appropriate section number in the Patent Law) is required in order to determine specifically whether the parties agreed that the employee will not be entitled to royalties.
- The Committee raises the possibility that, under the Patent Law, an employee does not even have the power to assign his or her rights to receive royalties, thus, possibly, resulting in the conclusion that any such assignment would be invalid. The Committee raises the question, but does not take a position.

It is important to note that the case was decided by a statutory committee and not by a court. The weight of its precedential impact is therefore not clear. Yet the decision reflects the view of the Committee that is empowered to decide on this issue and, in the absence of a court decision to the contrary, may indicate the tendency of the Committee in future disputes. Obviously, the impact on this matter on the Israeli high-tech sector is meaningful, and one may expect that the matter will be submitted to the court in the near future.

Our view is that the plain language of Section 134 of the Patent Law allows an employee to agree with the employer that the employee will not be entitled to any royalties on patents that result from inventions to which the employee contributed. Such an agreement does not constitute an assignment; rather it is an agreement on terms and conditions of a commercial arrangement. Therefore, the question whether the right to receive royalties is assignable is not the correct question. We believe the question should be: "Does the agreement between the employee and the employer provide that no royalties will be payable to the employee?" We believe that this is a matter of contractual interpretation that will be determined in each case on the basis of the specific provisions of the agreement with the employee.

Our Recommendations

Nevertheless, in light of the Committee's decision, an uncertainty has been created, which employers need to address. Employers who were acting under the assumption that they are not required to pay any royalties to employees for their service inventions, should review the invention assignment agreements signed with their employees in order to confirm that this assumption is well founded. Based on the conclusions from such review, employers should consider whether existing and new employees should sign new invention assignment agreements that address Section 134 of the Patent Law in a manner that supports the conclusion that no royalties are due.

In particular, we would suggest the following:

1. Review Form of Invention Assignment Agreements

Typical invention assignment agreements (including forms used by our firm) include a provision to the

effect that the employee shall not be entitled, with respect to the invention assignment, to any monetary consideration or any other consideration except as explicitly set forth in the employment agreement. These provisions essentially reflect the notion that the compensation paid to the employee includes all amounts that may be due to the employee in connection with creation of inventions. Employees, primarily in the technology sector, are hired, in part, in order to develop technology for the benefit of the employer. Therefore, the services provided by the employee include, as an inherent element, creation of inventions. The employment benefits paid to the employee are typically intended to constitute the consideration paid by the employer in order to benefit from the creativity of the employee. Our view is that invention assignment agreements that include such text, or similar text, are sufficient to conclude, under Section 134 of the Patent Law, that the employee agreed with the employer that no additional compensation will be paid to the employee in connection with the patented invention.

The Committee alluded to the need to specifically reference "service inventions" (for example by referring to Section 134) in order to eliminate a claim for royalties by the employee. Our view is that this question is a matter of interpretation of a contract, and that in most cases, the intention of the parties would be clear even without specific reference to a particular section number of the Patent Law. In most cases, such text should be interpreted to reflect the principle that the employee and the employer agreed that no additional compensation will be paid to the employee, and that there is no need to refer to all legal theories under which such right may arise, or to include "magic wording".

Agreements that do not contain any text that refers to the compensation under the employment agreement as the exclusive compensation are more vulnerable to the argument that the employee is entitled to royalties. However, we believe that strong arguments can also be made to the contrary. We believe that an employee that agrees to assign all inventions to the employer should be assumed to have agreed that no additional consideration will be paid in connection with the inventions created by such employee. We acknowledge that this view is different from the view of the Committee in the Ilani case.

2. Revising Current Agreements

Based on a review of existing invention assignment agreements, employers may wish to revise their existing agreements for new employees or have existing employees sign again revised invention assignment agreements. Obviously, the notion of requiring employees to re-sign invention assignment agreements raises various difficulties, and as noted above, we believe that the forms used by many companies are probably providing adequate protection. Accordingly, we would not necessarily suggest taking a wholesale approach to revising current employment agreements, even if they do not meet the strict standards set out in the Committee's decision. Nevertheless, for particular employees or particular inventions, it may be worthwhile to consider an amendment to the assignment agreements.

With respect to new invention assignment agreements to be entered into with employees we would suggest adding text such as the following: "Without limitation of any of the other provisions of this agreement, Employee irrevocably confirms that the consideration explicitly set forth in the employment agreement is in lieu of any rights for compensation that may arise in connection with the Inventions under applicable law and waives any right to claim royalties or other consideration with respect to any Invention, including under Section 134 of the Israeli Patent Law – 1967."

3. Due Diligence Considerations

In any M&A transaction, buyer's counsel should carefully review the invention assignment agreements to assess the exposure that it would need to pay compensation to employees for service inventions. The buyer should consider whether accommodations must be made for this now unknown liability to pay future compensation for service inventions.

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