The practicalities of inventor compensation in China

Inventor compensation varies significantly from one jurisdiction to another. China largely follows the German practice, and employers may be caught unexpectedly with no compensation plan in place. **Toby Mak** explains the legal basis, and the practical boundaries in China based on several Chinese court decisions. Thoughts on mitigating this issue with commercial considerations are also discussed.

The concept of inventor compensation (or renumeration) exists in many jurisdictions, including the UK, Germany, and Japan. Here is a brief summary:

In the UK, an employee may be entitled to compensation if there is an outstanding benefit to the employer, with the level of outstanding being quite high.

In Germany, the compensation is mandatory, which at the latest occurs once the patent is granted, and the patent has an economical value to the employer. The compensation is based on the net sales of the product, the contribution ratio of the inventor, and the common royalty amount.

The revised Japanese Patent Act 2017 recognises inventor compensation set by a contractual agreement if there was a proper negotiation between the employer and the employee (or his/her representative), with terms of the agreement being disclosed, discussed, and considered at the negotiation. Otherwise, a court may calculate the amount of compensation based on the profit made by the employer from the invention, the contribution to the invention by the employee, and how the employee is treated by the employer (for example, salary).

In the US, there is no federal law on inventor compensation. While there are state laws on this, employers are not obliged to pay.

My personal comments are highlighted. The section 'Practical considerations from a company perspective' are all my thoughts after discussions with my contacts, together with insights from a number of decisions from the Chinese courts.

Apparently, inventor compensation varies significantly from one jurisdiction to another. I will be grateful for further education on any jurisdictions, regardless of whether they are mentioned above or not.

Legal framework in China

Legal basis

The Chinese patent system is strongly influenced by the German system. The Chinese system requires a mandatory award to the inventor at grant, and compensation when the employer could make economic benefits from the invention. This is in article 16 of the current law, which is the same as article 15 in the new law (the fourth amendment just passed in October 2020, which has been force since 1 June 2021). The only difference between the current law and the new law is that article 15 in the new law specifies that compensation could be in various forms including equities, options, and dividends for compensation.

From this point on, for the sake of clarity, the following terms will be used for further discussion:

- 'Award' refers to the payment to the inventor when a patent is granted.
- 'Compensation' refers to the payment to the inventor when the employer could make economic benefits from the invention.

Details of stipulations on award and compensation in China for patented inventions

These are specified in the Implementation Rules of the Chinese Patent Law, specifically in articles 76-78 as detailed below:

1. Article 76 allows the entity being granted the patent to agree on the manner and amount of the reward and compensation stipulated under article 16 of the Patent Law.

If no agreement on reward and compensation exists:

2. Article 77 – rewards should be given to the inventor within three months from the date of grant of the patent as below:
- RMB(¥)3,000 for an invention patent; and
- ¥1,000 for a utility model or design patent. [This may be one of the origins where the impression that utility model is less valuable than invention patent is from.]

3. Article 78 – compensation after the patent is commercially exploited within the term of the patent as below:
- for invention patents or utility models, not less than 2% of the profit [strangely, utility models have the same percentage as invention patent for profit];
- for design patents, not less than 0.2% of the profit; and
- not less than 10% of any licence fees.

The above have **not** been changed in the most recent draft changes to the Implementation Rules published by CNIPA on 25 November 2020, and therefore, it should be expected that these will remain the same.

Awards and compensation for non-patented inventions

These are stipulated in the Law on Promoting the Transformation of Scientific and Technological Achievements (PTSTA Law), for which the current version was passed and came into force in 2015. The relevant articles 44 and 45 are as below:

- Article 44 – Individual with an 'important contribution' shall be awarded and compensated by the entity that completed the scientific achievement after the achievement 'is transformed'. [According to article 2 of the PTSTA Law, 'transformation of scientific and technological achievements' means the entire process of the follow-up tests, development, application, and promotion of the scientific and technological achievements, up to the final creation of new technologies, new techniques, new materials, and new products, as well as development of new industries – all for the purpose of enhancing the level of productive forces.] The entity could stipulate or agree with the scientific personnel on the form, amount and time limit of the award and compensation. When the stipulation is formed, opinion from the scientific personnel shall be sufficiently heard, and then notifies the scientific personnel.

- Article 45 – If there is no stipulations or agreements on awards and compensations, then the following applies:
  1. If the scientific achievement is assigned or licensed, at least 50% of the net proceeds of the assignment/licence shall be paid to the individual with 'important contribution'.
  2. If the scientific achievement is valued for investment, assigned or licensed, at least 50% of the equity shares or the funded ration shall be awarded to the individual with 'important contribution'.
  3. If the scientific achievement is practiced by the entity either alone or with another party, 5% of profit from practicing the scientific achievement shall be extracted for three to five years consecutively. [Article 45 does not make it clear what the extraction is for, but presumably to award to the individual with 'important contribution' as above. Otherwise, it does not make sense.]

The PTSTA Law is more general and directed to all forms of scientific and technological achievements, regardless whether these have been patented. On the other hand, as the Chinese Patent Law and its Implementation Rules have specific provisions on award and compensation of a granted patent, it could be argued that award and compensation of a granted patent is to be governed by the Chinese Patent Law and its Implementation Rules, while the PTSTA Law takes care of non-patented scientific and technological achievements.

Apparently, article 45 of the PTSTA Law is more rewarding to the 'inventor'. This may be intentional to 'encourage' companies to file more patents and not leave the achievements without patents. In particular, 3) in article 45 of the PTSTA Law does not require the individual to have an 'important contribution', while 1) and 2) do have an 'important contribution' requirement. In addition, it is unclear what would amount to an 'important contribution' (general guidance may be available at *Shanks v Unilever Plc* [2019] UKSC 45). Although this is a UK decision, the world is not that different in the underlying reasoning), with the stringent, and in many cases rigid, requirements on evidence in China, inventors may not be able to argue and prove their important contribution in a legal proceeding. Having said so, compensations stipulated in 3) in article 45 alone are already higher than those specified in the Chinese Patent Law and its Implementation Rules. Once a patent is granted, the employer could then argue that the award and compensation are no longer governed by the PTSLA Law, but governed by the Chinese Patent Law.

Practical considerations from a company perspective

If you are concerned with this, let me congratulate you, because you are having a happy problem – you do not have to be concerned if you are not making a huge profit from your invention. Now enough excitement, let us get down to business.

Salaries and bonuses do not count as award and compensation

This was tried in *PAN Xiping v Shenzhen Jiansha River Inv.Co., Ltd. (Jinsha River), Shenzhen Biovalley Pharmaceutical Co., Ltd. (Shenzhen Biovalley), Yunnan Biovalley Erigeron Pharmaceutical Co., Ltd. (Yunnan Biovalley) and* (2011, Guangdong High Court, decision no. 316, herein after the *Jiansha River* case), arguing that salaries and bonuses should be counted as award and compensation, but failed. Major points are as below:

- Shenzhen Biovalley is one of the invested companies of Jiansha River, and licensed to Yunnan Biovalley to practice the invention, which is an Erigeron (a Chinese medicine) formulation.
- Jiansha River argued that the salary and bonuses (yearly and quarterly) paid to the claimant had already included the award and compensation for the relevant patent.
- This argument was refused in the first and second instances on the basis that notifications related to salaries (issuances and adjustments) and employee evaluation forms could not prove that compensation had been paid.
- Shenzhen Biovalley and Yunnan Viovalley had no obligation to pay compensation to the claimant, as the two Biovalleys are separate legal entities from Jinsha River.
- As Jinsha River was the employer of the claimant, Jinsha River was responsible to pay the compensation.
- Jinsha River had no agreement (including any form of reward and compensation scheme) with the claimant, and therefore the court calculated the compensation based on the requirements in the Implementation Rules.
- While the claimant asked for compensation of ¥20 million, ¥1 million was awarded by the first instance court based on the following, which was affirmed at the second instance:
  - There was another inventor in addition to the claimant.
  - Jinsha River must have made profit by licensing the patent to third parties, but did not provide any details on the licence fee.

In addition to that, 'salary and bonuses do not count as award and compensation' unless otherwise specified, additional lessons to be learnt from this case are:

1. Who employs, who pays the compensation, even if the employer did not directly practice the invention. This was also affirmed in the case *CHEN Haidong v Coca-Cola Beverages (Shanghai) Co., Ltd.* (2019, Shanghai High Court, decision no. 497, hereinafter the *Coca-Cola* case), even when the patent was owned by the mother company Coca-Cola US.
2. If there is no agreement (including in the form of an award and compensation scheme), then the stipulations in the Implementation Rules kick in. If this is not desired, then please have an agreement with the employees.

Contracting out would not work

The immediate reaction of many companies and employers is just one sentence: 'I do not want to pay one extra cent.' Therefore, some companies try to 'contract out' the award and compensation from a patent, including a provision similar to the below in the employment contract:

- The employee hereby confirms that they have been sufficiently compensated (by their salary and/or a flat fee) for the award and compensation of any inventions created by the employee due to duties during the employment, regardless whether these have been patented. As such,

the employee agrees not to receive any further award and compensation of any invention from the company.

The basis of this attempt is article 76 of the Implementation Rules, in which the employer argues that the above is an agreement recited in this article 76.

The above is a bad idea for the following reasons:

a. At least in China, this is not in conformity with the Chinese Patent Law (see above, article 15 of the new Law). This was also affirmed in the *Coca-Cola* case. Coca-Cola tried to rely on the employment contract claiming it was allowed 'to use the invention for free in its business forever.' This was not accepted at the first and second instances.
b. This is bad to the relationship with the employee. At the very least, the employee would have little or even no motivation to proactively do the following:
   - timely disclose to the employer any invention made; or
   - assist the employer to have the patent granted.

Compensation paid before the patent is granted does not count

Because of b) above, many companies are willing to provide awards before and when patents are granted in a way even more generous than the law requires.

Furthermore, such generosity is also in the hope of deterring the employee from actively checking and asking for compensation, and tries to factor in such generosity when compensation is considered. However, it should be noted that compensation given before a patent is granted is exempted from consideration as proper compensation, as decided in *HUANG Shiwei v Lier Chemical* (2017, Supreme Court, Decision no. 4902). In this case, Huang was given 1% of Lier's stock and ¥100,000 as bonus before the relevant patent was granted, even before the patent was filed. Lier tried to argue that these were compensation for the relevant patent, but was refused by the first and second instance courts.

Award and compensation schemes that deviate too much from the law will not be recognised

This was illustrated in the *Coca-Cola* case:

- The subject design patent was filed in 2004, and granted in 2005.
- Coca-Cola announced its invention award and compensation scheme with an effective date of 1 June 2013 that would also cover inventions completed in China after 1 February 2010. The scheme provided ¥2,000 after an application was filed, and ¥3,000 after a patent was granted.
- On 5 August 2015, Coca-Cola notified the claimant that he would be paid ¥5,000 for the subject design patent, including ¥1,000 of award, and ¥1,500 of compensation. On 14 August 2015, the claimant replied that he was only recently aware of this design patent, and while accepting the award of ¥1,000, refusing to accept the compensation of ¥1,500. The claimant then filed a mediation request with the Shanghai Intellectual Property Office, but was not accepted as Coca-Cola did not reply within the time limit. The claimant then filed his complaint at the first instance court.
- The first and second instance courts ruled that Coca-Cola's invention award and compensation scheme deviated too much from the legal requirements, and therefore could not be considered as sufficient reward and compensation for the subject design patent. Because of this, the requirements in the Implementation Rules kicked in.

Compensation calculated based on contribution of the invention, and the number of inventors

While the detailed calculation was not included, the above was indirectly reflected in the following case:

- In *Coco-Cola*, while the claimant asked for ¥1 million, only ¥150,000 was awarded.
- In *Jiansha River*, while the claimant asked for ¥20 million, only ¥1 million was awarded.
- In a case related to 3M, while the claimant asked for ¥4.4 million, only ¥200,000 was awarded.

This is in line with how patent infringement compensation is assessed in China, and follows German practice. This is finally one piece of good news for employers.

Thoughts and suggestions for China

First of all, the stipulations under the Chinese Patent Law and its Implementation Rules only govern a Chinese patent. Good luck trying to sue for compensation of a non-Chinese patent in a Chinese court, and please let me know of the results. In summary:

a. Salary and bonuses do not count as award and compensation, unless otherwise specified.
b. Who employs pays the compensation, even if the employer did not directly practise the invention.
c. If there is no agreement (including in the form of an award and compensation scheme), then the stipulations in the Implementation Rules kick in.
d. Contracting out would not work.
e. Compensation paid before the patent is granted does not count.
f. Award and compensation scheme deviated too much from the law would not be recognized.
g. Compensation is to be calculated based on contribution of the invention to the profit, and the number of inventors.

As mentioned above, many employers are happy, or even eager, to provide lucrative awards to lure the employees to disclose

inventions they have made, and to assist in getting the patents granted. Some are also willing to provide compensation if profit, particularly significant profit, is made from an invention as the inventor(s) would be valuable to the employer (inventors are curious people and like to invent). If these inventor employees left and went to a competitor, this could be even more costly.

The major issue is the accounting requirements arise due to the following points under article 78 of the Implementation Rules:

- for invention patent or utility model, not less than 2% of the profit;
- for design patent, not less than 0.2% of the profit; and
- not less than 10% of the licence fee.

The above have to be done periodically (at least annually), with the determination of the contribution of the invention to the profit. These are cumbersome, and some companies do not even have the resource to do so, let alone willingness. For big companies with thousands of patents in possession, the monitoring involved is unthinkable.

Of course, to muddy the waters, companies could put the profits made from an invention in a Chinese patent into their worldwide sales, making it difficult for the employees to assess the actual profit made from the Chinese patent, or even be aware of the profit. However, if an invention is indeed successful, it is likely that someone or even the employers themselves are going to publicise the success, alerting the inventor employee. In fact, the Chinese cases discussed above all started with publications involving the employers themselves with the admission of the contribution of the invention to the success of the business. It is generally true that once it gets big, everyone knows. The discussion on compensation with the employee would have a completely different context if it was started by the employer proactively.

Finally, disputes on patent compensation could send undesirable messages to all inventor employees, affecting the overall morale. As such, I propose the following, which hopefully could make everyone happier:

1. Provide awards when a patent is granted as required by the Chinese Patent Law, or even in a more lucrative manner.
2. Consider additional awards when a patent application is filed to attract proactive disclosure from the employee.
3. Pledge to the employees that they would be notified if significant economic benefits, for example when the company is going to make an announcement of the success of a particular product/service or when the sales of the relevant product/service exceed a certain threshold, could be made from their patented invention to start a discussion.
4. For compensation, consider shares/equities and/or options rather than monetary compensation, which could tie the employee to the company more tightly, and it could be argued that the stock price could go up to match with the Chinese legal requirements.

The third point above could at least avoid the compensation scheme from being alleged of deviating too much from the Law, as the compensation is to be determined after the discussion. Further, this could avoid continuous need on profit monitoring. Additionally, once this happens, the investigation would include identification of patents that could be used to sue when the relevant product/service is infringed, and identification of contributing inventors that are of value. The information gathered therefrom would be useful to the company.

Regarding the fourth point, additional obligations on the inventor employee may be set with the execution of the option to further protect the company's interest and provide flexibilities. Some could be as below:

i. The option could only be fully exercised if the invention at issue is still being used by the company at the time of execution, otherwise, only a portion could be exercised. This could motivate the employee to improve on the invention.
ii. The subject patent is still valid when the option is exercised, otherwise, only a portion could be exercised. This could be used to incentivize the employee to assist the employer in defending the validity of the patent when necessary.
iii. The employee could only exercise the option after a certain period of time, and during this period the employee has to remain at the company, with satisfactory performance.
iv The number of shares obtained by the employee may increase over time.

The above are initial suggestions, and further polishing will be required. For example, more precise definitions of the following would be required:

- the invention at issue is still being used by the company at the time of execution;
- assist the employer in defending the validity of the patent when necessary; and
- satisfactory performance.

I am not an expert of employment and stock option laws. Furthernore, my thoughts and suggestions are not entirely law related, and may not be commercially practical for some companies. Therefore, any thoughts from fellow readers will be welcomed.

Toby Mak (Tee & Howe Intellectual Property Attorneys). Special thanks to the following friends for advice on the respective jurisdictions: **Sanji Miyagi** of Shobayashi International Patent & Trademark Office in Japan; Kay Rupprecht of Meissner Bolte in Germany; Victoria Hutton of Stratagem IPM and Dr. Michael Lord of Gill Jennings & Every in the UK.