Grant-Back of Improvements

EEC and German laws present certain problems; inventions of employees require special consideration

BY DR. HEINZ GODDAR*

Both exclusive and nonexclusive license agreements regularly contain grant-back provisions, i.e. either licensor or licensee or both will grant licenses to the other party as far as improvements of the licensed invention are made during the lifetime of the license agreement by the respective party. For the sake of clarity and simplicity we will understand, in the following, under "improvements" those that are, in general, protectable by either patent or utility model registration, doing so covering most of the improvements possibly causing any problems with regard to grant-back. The reason is that those improvements that cannot be kept secret by either party can be used by the other party anyway. There is no possibility to prohibit that by any contractual provisions without the severe violation of German and European (EEC) Antitrust Law.

On the other hand, licensing of secret know-how as well as obligations by either party not to disclose same presents specific problems. Dealing with them would make it necessary to extend this paper far beyond its extent possible by time and purpose. Improvements we have in mind here are those that can be patented or protected by utility model registration.

Requirements

By "license agreements influencing West Germany" we mean that the respective license agreement must fulfill two requirements:

1. One of the parties must be in such a position that its commercial acting will have influence onto the EEC marketplace. This does not necessarily mean that either of the parties has its legal residence within a member country of EEC!
2. That either of the parties has employees to which the provisions of the German Law relating to Inventions of Employees are applicable.

One could say that the aforementioned provisions are fulfilled for the purpose of our today paper, if either licensor or licensee is a company having its location in West Germany and employing, among others, German employees whose inventions are of importance for the license agreement in question.

To simplify even more, and to restrict ourselves definitely to the "grant-back" of improvements, we shall mainly consider the situation where the licensee if a party having its residence in West Germany and having German employees, while the licensor may be a subject of similar nature or may be, e.g. an Australian company.

Grant-back of improvements under EEC Law—restriction by law and according to jurisdiction

(Editor's Note-The draft regulation has become law since the author wrote the following.) The basis for any judgment whether a certain grant-back provision contained in a license agreement will be allowable under EEC Law still reliably has to be the draft regulation of the European Commission concerning the applicability of article 85, par. 3, of the Roman Treaty to patent license agreements, in its present version. This draft, as you know, was last revised in 1979, but never has come into force, and now is subject to a further revision by the Commission taking into consideration the most recent decision of the European Supreme Court: "Maize Seed" of June 8, 1982, published e.g. in GRUR Int. 1982, vol. 8/9, page 530.

Following the present form of the draft regulation which again takes into account the jurisdiction of the European Supreme Court in this respect, particularly the Spitzer-Vanhol-Decision (GRUR Int. 1983, vol. 10, page 805), it is permitted to provide in (exclusive and/or nonexclusive) license agreements of the kind in question the obligation of licensee to grant back to licensor any improvements of the licensed inventions on a nonexclusive basis, if, which is a very important feature, the licensor also bears a similar obligation. It is to be noted that there is no possibility for an exclusive grant-back of improvements. Rather, this would clearly be against article 85 (3) of the Roman Treaty in its interpretation by the European Supreme Court and the Commission and furthermore there is no possibility for a grant-back obligation of the licensee without a similar obligation of licensor.

On the other hand, as far as EEC law is concerned it does not play any roll whether the back licensing is provided royalty-free or royalty-bearing.

Therefore, let's keep in mind that license agreements being in line with the EEC jurisdiction may contain obligations of both licensee and licensor, but not only of licensee, to grant further licenses under improvements on a royalty-free or royalty-bearing basis to the other party, such obligation not having to be exclusive as far as back licensing from licensee to licensor is involved, however.

Grant-back of improvements based on inventions made under German Law relating to inventions of employees

As soon as inventions made by employees of German

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companies are subject of license agreements, one has to keep in mind that the provisions of the German law relating to inventions of employees are always applicable. It is not possible to exclude the consequences of this law by any contractual agreement between employer and employee in Germany. The respective provisions are binding.

Consequently, irrespective of what licensor and licensee agree on with regard to inventions made by employees, these contractual arrangements can only be valid in so far as they are in line with the provisions of the law relating to inventions of employees. Therefore, in the following we shall shortly have to discuss the accessibility of employees' inventions to German employers as well as the duties of the employer in relation to his employee.

Factual access of employer to employees' inventions

According to German law, an invention made by the employee first of all is the original property of employee and can by no contractual means be made, with factual effect and thereby excluding the legal provisions, the property of the employer. The employee, however, is obliged to notify an invention made by him to his employer immediately.

Thereupon, within a certain legal term the employer has the possibility to "unlimitedly" claim the invention. The effect is that by doing so the respective employee's invention becomes the property of the employer. The employer is thereupon entitled (and obliged!) to obtain industrial property protection, e.g. by patent or utility model registration, for the respective invention in its own name.

Consequently, the employer is able and in a position to make the respective invention subject of license agreements of any kind. Also, a provision under a license agreement that further inventions should be granted-back by a licensee to a licensor is possible, since the aforementioned provisions of the German Law give a definite title in any invention an employee makes to the employer.

Remuneration duty of employer—calculation of remuneration in general

While, as we have seen, the employer has factual access to any invention made by an employee, by claiming the invention unlimitedly a title of the employee in special remuneration is created, such title and right of the employee not being deletable by any contractual arrangement between employee and employer in advance. In other words, it is not possible that a German employer agrees with a German employee of a certain remuneration for an invention not yet notified and claimed in advance, particularly not in the form that the employee renounces any remuneration. Because of this general rule it is rather difficult for an employer to include inventions not yet made, e.g. improvements to be granted-back as we discuss here, into any agreement. At least certain provisions have to be taken into account because of this special situation.

To understand the following remarks, in general the remuneration the employee is entitled to get is calculated as a certain percentage of the value the invention has for the employer. If, for example, the employer uses the invention in its own factory, the usual way to calculate the value of invention is the so-called license-analogy. The value of the invention is considered to be equivalent to the royalties the employer would be willing to pay to a third-party inventor, not its employee, to get the exclusive right for using the invention. The percentage of this value of invention the employee inventor is entitled to get depends on the contribution of the employer on one side and the employee on the other side in creating the invention.

As a matter of course, it is more difficult to calculate the value of an invention on which the remuneration of the employee inventor is based if the employer does not use the invention in its own factory, but makes use thereof by granting a license thereon. In such a case the net royalty income of the employer, in general considered to be between 20% and 50% of its royalty income, is considered to be the value of invention again, the employee is entitled to a certain percentage, for example 10%.

If no royalty payment is provided for in a license agreement the employer conducts with a certain party, rather the employee's invention concerned is just part of a know-how exchange agreement or, in the case we are discussing, of license exchange agreements, namely grant-back of improvements. Nevertheless the employee is still entitled to a remuneration based on the value of the invention to be estimated in this case.

Remuneration of employee in case of royalty-bearing back licensing

From the above remarks it can be seen that there will be no difficulty arising from German law relating to inventions of employees if the grant-back provision of the license agreement provides for a certain royalty to be paid by licensor to licensee for such improvement grant-back. In this case, a certain percentage of the royalty to be paid by licensor to licensee for the improvement grant-back, e.g. the 50% mentioned above. That would be considered to be the value of invention, and in this case the licensor's employee would be entitled in a remuneration being a certain percentage again thereof, e.g. 10%.

Remuneration of employee in case of non-royalty-bearing back licensing

The situation is more difficult, however, if a royalty-free back licensing of improvements is provided in the license agreement. In this case the legal position will be that in fact the provided royalty-free back licensing will be a part of the overall royalties to be paid by licensee to licensor. It therefore has to be added to the nominal royalty rate agreed. In other words, the invention made by an employee of the licensee would have the effect that a lower nominal royalty rate would have to be paid. It would have to be estimated how much reduction by nominal royalty rate is achieved in this way by licensee.

Let's assume a case in which a nominal royalty rate of 5% has been agreed. Let's further assume that we have a provision according to which improvements made by licensee are to be back licensed royalty-free. In this case experts might come to the opinion, particularly experts like the Arbitration Committee for Employees' Inventions at the German Patent Office, that without such provision the royalty rate would have been 6%.

In this case, therefore, the licensee would have the duty to pay to his employee a remuneration based on the difference between nominal royalty rate and otherwise payable royalty rate, i.e. 1% in our instance. Similar observations will apply, of course, as far as improving inventions of employees of licensor are to be included into an existing license agreement on a royalty-free basis.

Possible influence of remuneration payable for improvements onto earlier licensed inventions

A special aspect of improvement inventions made during the life period of a license agreement and included into the existing license agreement is that inventions originally licensed—and being subject to remuneration already to inventors—may be influenced by such further inventions. The easiest way to see this is not the case where an improvement is back licensed, but where further improvements by licensor are automatically included into the license agreement. If we assume that originally one single invention made by a certain employee of licensor was subject of the license agreement, the agreed on royalty being 5% again, the aforementioned employee would be entitled to remuneration based on the value of invention of 5% royalty.

If further improvements are automatically licensed, without any increase in royalty rate, the licensor nevertheless would still have to pay remuneration to his employee. This assumes this is a different one, as far as the further improving inventions are concerned, reducing the participation of the original inventor in the complete royalty. The argument in such a case is that the royalty obtainable by licensor from employee is the highest possible one, if there is no provision for any increase thereof in case of further improvements. In a case in which a single licensed invention is replaced by a complex of inventions, e.g. three or four, the highest obtainable royalty has to be divided among these single inventions according to their respective contribution to the overall licensed value.

While in this "direction," i.e. in the case of granting licenses also under improvements, apparently there are no serious problems involved, problems can arise in cases in which many improvements by licensee are to be back licensed royalty free. In that case one could argue that the real value of the license agreement for the licensee goes far beyond the obvious provisions of the license agreement. Rather serious investigations of certain authorities, e.g. antitrust authorities, quite frequently are the consequence in case of such a discrepancy between the duties of parties in a license agreement and the obvious advantages they take.

Conclusions

From the above, first of all one should learn that because of EEC law only "balanced" provisions relating to further improvements of licensed inventions should be included into license agreements. Furthermore, in order to avoid serious problems with regard to German law relating to inventions of employees, whenever possible royalties should be agreed on for eventual improvements to be licensed in either direction. At least the grant-back conditions should be equal, i.e. if royalty free, then in both directions, since in this case the remuneration basis for employees could be estimated by considering the respective improvement inventions without taking into consideration the basic license agreement.