

## LEGAL UPDATE – AUGUST 2012

### RECENT SUPREME COURT DECISION REGARDING EMPLOYEE SERVICE INVENTIONS

Last week, in a decision sure to have repercussions for the high-tech industry, the Israeli Supreme Court held in *Beyer vs. Plurality Ltd.*<sup>1</sup> (the “Decision”) that where an employee has signed a written waiver relinquishing rights to royalties or other compensation for service inventions, the employee is nevertheless not barred from seeking royalties and other compensation before the Committee for Compensation and Royalties (“Committee”) established under the Israeli Patent Law - 1967 (the “Patent Law”). The Decision may result in an increase of compensation claims from employees, and creates an environment of uncertainty for employers and purchasers of Israeli high tech companies and technologies.

#### Background

Section 132 of the Patent Law defines as a “Service Invention” an invention which is created within the scope of and during the term of an employee’s service for the employer. The Patent Law stipulates that absent an agreement to the contrary, Service Inventions are the property of the employer. While included as part of the Patent Law, this provision applies to “inventions” generally, and its application is not limited to patented inventions.

Section 134 of the Patent Law states that absent an agreement governing the existence and scope of an employee’s right to royalties or other consideration in respect of Service Inventions, the Committee for Compensation and Royalties<sup>2</sup> of the Israeli Patents Registrar of Patents (the “Committee”) is authorized to determine the scope of consideration to which the employee is entitled on account of such Service Invention. Section 135 of the Patent Law establishes guidelines governing the decision making of the Committee in this matter.<sup>3</sup>

The technology industry has customarily relied on contractual undertakings with employees to resolve the question of what compensation, if any, an employee is entitled to receive for service inventions. For example, founders who contribute technology to emerging companies routinely receive equity in the company as compensation for their contributions to the company's technology; in exchange, these employees waive their rights to further royalties or other compensation for service inventions. Employees who join after the establishment typically waive the right to received compensation for Service Inventions as part of their employment agreement. Until now, as is suggested by the plain language of Section 134, once such an agreement was signed, it was understood that the employee did not have the ability to challenge (and generally did not seek to

<sup>1</sup> CA 3564/12 Beyer vs. Plurality Ltd.

<sup>2</sup> The Committee is established by the Justice Ministry at the Registrar of Patents, Designs and Trademarks pursuant to Section 109 of the Patent Law, 1967, and consists of a Supreme Court justice, the Registrar of Patents and an additional member from academia (the “Committee”). According to Section 111 of the Patent Law, the Committee's jurisdiction in these matters is exclusive and decisions handed down by the Committee are final. It should be noted however, that insofar as Service Inventions are concerned, Section 136 of the Patent Law grants a petitioner the right to initiate a request for a rehearing by the Committee of an earlier ruling by the Committee, if circumstances have changed from the time of such earlier decision.

<sup>3</sup> Patent Law, 1967, §135; The Committee in making a decision pursuant to Section 134 is to consider (i) the role and responsibility of the employee, (ii) the degree of connection between the invention and the employee's work, (iii) the initiative of the employee in developing the invention, (iv) the possibility of utilizing the invention and any actual such utilization, and (v) any reasonable expenses under the circumstances which were outlaid by the employee in order to obtain protection over the invention in Israel.

challenge) the contractual arrangement before the Committee. The reliability of this practice is now in question following the recent Supreme Court decision.

## The Decision

According to facts in the Decision and information available on the Plurality company website, Dr. Nimrod Beyer was a co-founder of Plurality, and formerly served as the company's chief technology officer and executive chairman. In 2007, Beyer signed an agreement assigning all service inventions to the Company and waiving all rights to further compensation or royalties with respect thereto, other than amounts to which Beyer was otherwise entitled under the agreement. In the context of liquidation proceedings involving the company, Beyer requested to submit a claim for additional compensation for service inventions to the Committee, notwithstanding the waiver which he had signed. The lower court had upheld the traditional practice and, in a one-sentence ruling, denied Beyer's claim outright due to the existence of an agreement waiving rights to royalties or other compensation for service inventions.

On August 1, this ruling was overturned by the Israeli Supreme Court, which remanded the case to the district court for ruling on the merits. Applying a novel interpretation of Section 134, the court held that Section 134 grants the Committee jurisdiction to hear compensation claims not only absent an agreement between the employer and employee, but also where an agreement is in place but the agreement does not entitle the employee to royalties or other compensation for service inventions, including where the employee has waived all rights to compensation.

In its decision, the Supreme Court cited a widely reported 2010 Committee decision Actelis Networks vs. Ishai Ilani.<sup>4</sup> While employed by Actelis, Ishai Ilani had signed an agreement assigning service inventions to his employer; however, the agreement did not contain an express waiver of royalty or compensation claims. The Committee ruled that an employee's assignment of a service invention to his employer does not necessarily negate the employee's right to receive royalties or other compensation. Following the Actelis decision, many Israeli companies bolstered their invention assignment agreements with express royalty waivers to the extent their agreements did not previously include such terms.<sup>5</sup>

In the Plurality decision, the Supreme Court went one step further, ruling that even where the employee has signed an express written waiver of royalties for service inventions, the employee can still bring a compensation claim before the Committee. The reasoning behind the Beyer decision is somewhat unclear, as the decision suggests that Beyer was in fact entitled to payment, and the waiver merely related to any additional payment in excess of amounts due to him under the agreement. However, the decision's impact is clear - even if an employee signs an agreement with his employer waiving his right to royalties or other compensation for service inventions, the employee may nevertheless bring a claim for royalties or other compensation before the Committee.

The Plurality decision favorably cited the Committee's statement in Actelis that it is possible that the right to receive compensation for service inventions is "an inherent right, constituting an inalienable part of the protective labor law". The impact of this statement is that employees cannot effectively waive the right to receive compensation for service inventions.

---

<sup>4</sup> Request for Determination of Consideration for Service Patent (Motion for Summary Dismissal) Actelis Networks vs. Ishai Ilani, decision dated February 3, 2010. While records of Committee proceedings are not by law available to the public, the Committee on occasion publishes its decisions.

<sup>5</sup> The Israeli press has reported that Ilani's claim against Actelis was settled for an undisclosed amount.

## Analysis and Recommendations

The Decision allows employees to challenge waivers of compensation rights for service inventions. It does not establish an affirmative employee right to compensation for service inventions. However, the mere existence of a (potentially baseless) employee compensation claim can have severe consequences when raised in the context of a merger, acquisition or asset sale. Faced with actual or threatened claims, many companies may opt for a quiet settlement.

In addition, the Supreme Court's favorable citation of the Committees' view that employees' rights to receive compensation for service inventions may be "an inherent right, constituting an inalienable part of the protective labor law" leaves open the possibility that Israeli courts, or the Committee, may in the future find employees eligible for compensation for service inventions even where rights to such compensation have been clearly waived in written agreements. We note that decisions of the Committee are final and not subject to appeal.

The Supreme Court's interpretation of Section 134 suggests that where an employer and employee are party to an agreement where the employee receives some compensation for service inventions, and does not waive rights to compensation in their entirety, the Committee would not have jurisdiction to hear compensation claims.

There are number of mechanisms which may be employed to ensure that employees have received compensation for service inventions. One alternative is to replace standard waiver language in employee invention forms with an employee acknowledgement that option grants are compensation for service inventions. Where no options are granted, companies may adopt a payment structure which would compensate employees for service inventions.

Alternatively, employment agreements can set a certain fixed monthly payment<sup>6</sup> as consideration for service inventions (similar to current practice in respect of overtime due under local labor law). In certain unique situations, it may be advisable to audit existing technology portfolios and offer additional compensation to key contributors.

However these measures may be premature pending further guidance on what compensation structure Israeli courts or the Committee would view as adequate. The court's statement that a right to payment may be an "an inherent right, constituting an inalienable part of the protective labor law" suggests that the mere existence of compensation may be insufficient where the compensation does not fairly reflect the employee's contribution to the employer's intellectual property.

Alternatively (or in addition), to discourage compensation claims, a "Gidron Clause" may be incorporated in inventions assignment and waiver agreements, stipulating that where a compensation claim is brought, the employee's salary is automatically and retroactively reduced by a stated percentage (or some other "penalty" is imposed, such as the cessation of the vesting of options). However, the enforceability of such a clause is unclear.

For companies seeking to reduce risks presented by the Decision, our practical recommendations will vary on a case by case basis and will be largely dependent on the factual context of each situation. With respect to existing employees, we urge companies to carefully weigh the pros and cons of awakening a potential source of contention with employees.

Companies contemplating the purchase of Israeli companies or technology should be aware of the

---

<sup>6</sup> The tax consequences of this and some of the other proposed mechanisms would need to be considered.

# YIGAL ARNON & Co.

L A W F I R M

risks posed by the decision.

## Contact Details

Please feel free to contact Yoheved Novogroder ([yohevedn@arnon.co.il](mailto:yohevedn@arnon.co.il)) or Shira Lahat ([shiral@arnon.co.il](mailto:shiral@arnon.co.il)) with any questions you may have.